A STUDY ON ECONOMIC DEVELOPMENT OF BANGLADESH BY PROMOTING TRADE UNDER WTO SYSTEM: CURRENT TRENDS, PROBLEMES AND PROSPECTS

By

MD. SALAHUDDIN AHMED

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

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Committee in charge:

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ABSTRACT

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MD. SALAHUDDIN AHMED

Economic Development of Bangladesh through fostering growth in trade under the WTO system depends on two crucial factors in this era of globalization. Firstly, sustainability of the Readymade Garments Sector (RMG) in the post- Multi Fibre Arrangement (MFA) period and secondly, mitigating trade gaps with its major trading partners through enhancing trade by diversifying its products and exploring the markets that are not yet been accessed.

Bangladesh became the member of the World Trade Organization (WTO) on 1 January 1995, on the very first day of formation of the WTO. Bangladesh has trade relations with India, Nepal, Pakistan, China, South Korea, USA, EU and many other countries. Ready Made Garments (RMG) is the main export that account for considerable number of employment generation in the country. Bangladesh had been exporting ready-made garments to EU and USA under Generalized System of Preference (GSP) facility until December 2004. But from 1 January 2005 such main export came under serious threat due to withdraw of GSP facility. Bangladesh has also a huge current account deficit in trade with India. So, for the sake of rapid economic development, Bangladesh needs to address urgent issues to intervene and to overcome such problems.

World trade in textiles and garments had been governing by the Multi Fibre Arrangement (MFA) since 1974. Through the MFA industrialized countries have been able to restrict imports of garments from developing countries. This 'protectionist' agreement could not prevent that some of the developing countries have captured a prominent part of world's market. Because of its status as one of the Least Developed Countries (LDCs), Bangladesh could circumvent part of the MFA. It has profited from the free entrance to the European market. Also the United States has enlarged the scope for imports from Bangladesh under Generalized System of Preference (GSP). This combined with low wages, made Bangladesh a highly attractive country for the intermediaries.

This study analyses the prospect of economic development of Bangladesh by promoting trade under the WTO system in the post MFA period by addressing several research questions: (a) what are the immediate measures to be undertaken to cope up with the enhancing competition in the RMG sector in the post MFA period? (b) What should be the policy interventions to mitigate bilateral trade gap with India? (c) What are the opportunities, threats and options for Bangladesh in the World Trade Organization (WTO) era? The study also examines the growth trend of RMG sector by using the time series data of 1974-2008 with the help of cointegration and error correction methods.

The empirical results exhibit the presence of a long-run relationship among the total RMG exports and its major determinants of total export earnings, GDP, gross fixed capita formation as share of GDP, trade Openness (trade-GDP ratio) and government consumption. The coefficient of error correction term has been found to be statistically significant with appropriate sign. The findings of the study suggest the importance of trade openness/liberalization policies in order to enhance economic growth through enhanced RMG export earnings in the long-run.

As the Bangladesh economy at present is more globally integrated and facing much more competition in the international market than at any time in the past, the MFA phase out provides an opportunity to expand trade, generate new employment and achieve higher rate of growth if Bangladesh can improve its competitiveness. RMG sector of Bangladesh needs to diversify its exports, improve quality of products, and establish backward linkage industries to increase value addition and to establish relevant industrial infrastructures to increase competitiveness. In order to improve the competitiveness of RMG sector and avail the opportunities of the quota free world the government and the business associations dealing with RMG sector should work together in partnership. Bangladesh also needs to give more attention to its physical infrastructure, governance, and the financial system of the country in order to acquire more benefits of the globalization and to accelerate growth and reduce inequality and poverty.

A more liberal trade policy regime over the next decade is likely to present opportunities for greater market access to Europe, North America and different other potential destinations, but at the same time competition may be intensified as more textile producers would seek to take advantage of the market opportunities. Bangladesh may use the forum of the World Trade Organization for its integration with the global economy and extract the best opportunities to its rapid economic development by enhancing trade.

DECLARATION

I hereby declare that no portion of the work referred to in the dissertation has been submitted in support of an application for another degree or qualification of this or any other university or other institution of learning.

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This piece of work has been accomplished with the active support of many people, who contributed through sacrificing their precious time and providing thoughtful ideas, giving proper directions and motivations. I am indebted to my supervisor Professor Jong Bum Kim for his kind acceptance to become my thesis supervisor.

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This dissertation is dedicated to my parents.

ABBREVIATIONS AND ACRONYMS

ADF	Augmented Dickey-Fuller
AGOA	African Growth Opportunity Act
ASEAN	Association of South East Asian Nations
ATC	Agreement on Textiles and Clothing
ATPDEA	Andean Trade Promotion and Drug Eradication Act
BDXDP	Bangladesh Export Diversification and Development Project
BDV	Brussels Definition of Value
BGMEA	Bangladesh Garments Manufactures and Exporters Association
BIDS	Bangladesh Institute of Development Studies
BKMEA	Bangladesh Knitwear Manufactures and Exporters Association
BTMA	Bangladesh Textile Manufactures Association
CBA	Collective Bargaining Agency
CBI	Caribbean Basin Initiative
CBTPA	Caribbean Basin Trade Partnership Act
CBW	Central Bonded Warehouse
CGE	Computational General Equilibrium
CM	Cutting and Making
CMT	Cutting, Making and Trimming
DEDO	Duty Exemption and Drawback Office
EBA	Everything but Arms
EC	European Council
ECM	Error Correction Model
EER_M	Effective Exchange Rate of Imports
EER_X	Effective Exchange Rate of Exports
EPB	Export Promotion Bureau
ELG	Export Led Growth
EPZs	Export Processing Zones
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
FDI	Foreign Direct Investment

FOB	Free on Board
FSRP	Financial Sector Reform Programme
FTAs	Free Trade Areas
FY	Financial Year
GATT	General Agreement on Tariff and Trade
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
GSP	Generalized System of Preferences
GTAP	Global Trade Analysis Project
HS	Harmonized System
ICT	Information and Communication Technology
IMF	International Monetary Fund
IPO	Import Policy Order
ISAC	Industrial Sector Adjustment Credit
ISI	Import Substitution Industrialization
ITCB	International Textiles and Clothing Bureau
JJML	Johansen-Juselius Maximum Likelihood
LC	Letter of Credit
LDCs	Least Developed Countries
MDG	Millennium Development Goals
MFA	Multi-Fibre Arrangement
MFN	Most Favoured Nation
MNC	Multi-National Corporations
MOC	Ministry of Commerce
MOF	Ministry of Finance
NAFTA	North America Free Trade Area
NBER	National Bureau of Economic Research
NCB	Nationalized Commercial Banks
NGO	Non-Governmental Organizations
NICs	Newly Industrializing Countries
NIP	New Industrial Policy
OECD	Organization for Economic Cooperation and Development

PMAP	Post-MFA Action Programme
QRs	Quantitative Restrictions
PRSP	Poverty Reduction Strategy Paper
PSI	Pre-Shipment Inspection
PTAs	Preferential Trading Arrangements
PTS	Primary Textile Sector
R&D	Research and Development
RATs	Regional Trading Arrangements
REER	Real Effective Exchange Rate
RIP	Revised Industrial Policy
RMG	Readymade Garments
RoO	Rules of Origin
SAARC	South Asian Association for Regional Cooperation
Sadd	Special Additional Duty
SAF	Structural Adjustment Facility
SAFTA	South Asian Free Trade Agreement
SAP	Structural Adjustment Programme
SAPTA	South Asian Preferential Trading Arrangement
SITC	Standard International Trade Classification
SMEs	Small and Medium Enterprises
SOE	State Owned Enterprises
TIP	Trade and Industrial Policy
USA	United States of America
USITC	United States International Trade Commission
VAT	Value Added Tax
VAR	Vector Autoregressive
WTO	World Trade Organization

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CHAPTER I

INTRODUCTION

Economic Development of Bangladesh through fostering growth in trade under the WTO system depends on two crucial factors in this era of globalization. Firstly, sustainability of the Readymade Garments Sector (RMG) in the post-Multi Fibre Arrangement (MFA) period and secondly, mitigating trade gaps with its major trading partners through enhancing trade by diversifying its products and exploring the markets that are not yet been accessed.

Bangladesh became the member of the World Trade Organization (WTO) on 1 January 1995, on the very first day of formation of the WTO. Bangladesh has trade relations with India, Nepal, Pakistan, China, South Korea, USA, EU and many other countries. Ready Made Garments (RMG) is the main export that account for considerable number of employment generation in the country. Bangladesh had been exporting ready-made garments to EU and USA under Generalized System of Preference (GSP) facility until December 2004. But from 1 January 2005 such main export came under serious threat due to withdraw of GSP facility. Bangladesh has also a huge current account deficit in trade with India. So, for the sake of rapid economic development, Bangladesh needs to overcome such problems.

World trade in textiles and garments had been governing by the Multi Fibre Arrangement (MFA) since 1974. Through the MFA industrialized countries have been able to restrict imports of garments from developing countries. This 'protectionist' agreement could not prevent that some of the developing countries have captured a prominent part of world's market. Because of its status as one of the Less Developed Countries (LDCs), Bangladesh could circumvent part of the MFA. It has profited from the free entrance to the European market. Also the United States has enlarged the scope for imports from Bangladesh under Generalized System of Preference (GSP). This combined with low wages, made Bangladesh a highly attractive country for the intermediaries.

The ready-made garment industry, largely based in the capital Dhaka, Narayangonj and the major port Chittagong, is about 30 years old. The number of garment factories has grown from about 300 in 1978 to about 3500 today. The garment industry now employs 2.0 million people (15% of all industrial employment), 90% of them are women. Through the spectacular growth, the garment industry until December 2004 was Bangladesh's top earner that covers more than 60% of total exports. Export rose from \$31 million in 1983 to

$11,878.92 million in 2008. However, only about 30% of the proceeds of the garment export remain in the country. The other 70% is used mainly for the import of fabrics, cotton and accessories from East Asia countries. The main market in the mid-1980s was the United States. In 1994 the United States still accounted for 52% of garment export from Bangladesh. The percentage has declined to 39.33 today. Europe now takes about 54% of its exports.

Multi Fibre Arrangement (MFA) in global textile and clothing trade had opened the doors for Bangladesh creating a golden opportunity for Bangladesh for exploiting its comparative advantage in the labour-intensive garments industries. Gradually, Bangladesh has been recognized as a major exporter of garments in the world. In fact, ready-made garments industry has become the lifeline of Bangladesh's economy. Despite being a source of strength for the economic growth, yet in a way it could be the cause of its vulnerability being too much depended on this sector. About two million people are employed directly, and another one million is involved in the backward linkage industries-altogether supporting the livelihood of some 10 million people of Bangladesh, who have been lifted out of poverty by integrating with the process of economic activities. The fact that most garment workers are females has itself brought on a revolution of sorts-in acceptability of women in the workplace; in bringing respectability to these women in their homes and in the rural settings they come from.

Yet the revolution is not over. Contrary to dire prediction of some analysis, the end of MFA has not dampened the competitive spirit of the dynamic first generation garment entrepreneurs. The have seen vast opportunities with the lifting of quotas. But they are facing intense competition from well-heeled competitors. This study makes a comparative analysis of pre and post MFA RMG export scenario of Bangladesh and also tries to see the trends of RMG exports, total export earnings and GDP growth over a period.

Trade liberalization has been playing an important role in the process of economic development of Bangladesh through enhancing trade. Bangladesh's trade liberalization efforts started in the mid-1980s as an important component of structural adjustment programme sponsored by Breton wood institutions-the World Bank and International Monetary Fund. Initial step were *ad hoc* and focused on the removal of quantitative import restrictions. But in the early 1990s extensive trade policy reform programme was put in place. Compared to the highly restrictive and inward-oriented nature of the trade regime prevailed before the mid-1980s, today Bangladesh has a less restrictive and more outward-oriented trade policy environment. This is a result of the commendable progress made in eliminating a sizable portion of both import tariff and non-tariff barriers and adopting a flexible exchange rate policy. Since RMG exports of Bangladesh contributed to 65%-72% of total export earnings throughout the last decade and RMG exports highly depend on the imports of fabrics and other accessories, hence trade liberalization helped immensely to the rapid growth of RMG exports. This study examines empirically the impact of trade openness on RMG export earning.

Bangladesh is concerned, for quite a long time, for its persistent and unfavorable trade deficit with India. The Bangladesh's trade deficit ballooned to about a billion in recent years (971.52 million dollar in 2001-02) from $53.3m in 1985 and has been growing steadily since the early 1990s. Exports from India far outweighed imports from Bangladesh, resulting in a yawning trade gap. Bangladesh has been pushing India to narrow down the huge trade imbalance and so expecting greater market access to India of its products. Recently, with mutual tariff concessions by both the countries and removing of trade barriers by India the trend of the trade gap is showing the sign of abating that led to a strong pick up in the exports of Bangladesh. The signing and ratification of South Asia Free Trade Agreement (SAFTA) in early 2006 by the two countries sets forth the possibility of further consolidation of trading arrangement through the formation of bilateral Free Trade Agreement (FTA). In this context Bangladesh has requested India, in different levels, for tariff exemptions on 191 items, of which India agreed to 40. But the duty-free access to 40 items will not make much difference considering the size of the trade imbalance and the demand for those categories of product in Indian market. In the past, Bangladesh referred to the non-tariff barriers faced by some of its exports to India, in general, and to West Bengal in particular. There is also crucial concerns on the Bangladesh side include the massive trade deficit with India that the large volumes of informal imports from India across the land border which avoid import duties of Bangladesh. For India, although trade with Bangladesh currently is very small, the potential of Bangladesh as an emerging market on India's borders will evince great interest for the business and investor communities.

Bangladesh can reduce its trade imbalance in different way. It can press India more on the customs, tariff concessions and associated administrative procedures to facilitate unhindered flow of trade between the two countries and to address these issues on a priority basis. We need to negotiate more with the Indian government on luxury tax levied by Indian government on some Bangladeshi exports and take strict measures on dumping of Indian goods into Bangladesh market at highly reduced price. India would import such products from Bangladesh if it has demand for them. Bangladeshi businessman should look forward to Indian market for which India make demands. Given the nature of Bangladesh's export and its dependence on the Ready Made Garments (RMG) sector, it would not be easy to reduce the trade deficit significantly without altering the Bangladesh's export bundles and relative efficiency in producing the goods and services to be exported.

Bangladesh has also staggering trade imbalance with countries like China, Japan or South Korea. However, a huge trade deficit with one country like India is not at all desirable as Bangladesh may be in a vulnerable situation in the event of any shock in India. The most important thing that the government can do to reduce its overall trade deficit and in particular trade deficit with India is to trim down its budget deficit. Government budget deficits and trade deficits are linked, the larger a country's budget deficit, the larger its trade deficit. Government is running up large budget deficits during the past decades without a corresponding increase in private saving relative to investment

Since India is the Bangladesh's major source of import, an increase in the government spending will deteriorate the trade imbalance with India and so Bangladesh government should direct its expenditure keeping its budget deficit at a minimum without sacrificing the capital accumulation and future living standards within the country. Furthermore the issue of trade balance with India has assumed emotional scale to a certain degree although it should not be viewed with emotions. Therefore the government should maintain the budget deficit at an acceptable level and create facilities, infrastructure to boost up its export, help injecting more domestic and foreign investment into the economy. A failure to do so would imply the loss of country's future potential and sacrificing the future generation's consumption possibility.

The purpose of selecting this topic as my thesis is to carry out a comprehensive study over the changed scenarios of the world market of RMG and to try to find out alternative measures to keep up 2004 level of export in the sector to maintain the current level of economic growth. At the same time, my purpose of this thesis is to examine the bottlenecks of trades with India and to find out the major causes of balance of payment deficit with India and to suggest appropriate measures to improve current situation in compliance with WTO rules and regulation. Finally, to suggest appropriate measure in some other areas of both commodity and service trade that might boost up economic development of the Bangladesh.

CHAPTER II

ECONOMIC DEVELOPMENT STRATEGY IN COMMODITY AND SERVICE TRADE OF BANGLADESH

2.1 Introduction

Economic development of Bangladesh has direct link with the growth of the external sector of the country i.e. growth in the commodity and service trade sector. Government has been undertaking various measures and strategies to boost up the growth of the sector. Sustained growth since 90's till June 2008 reflects the resilience of the economy of Bangladesh. GDP over the last five years achieved more than 5 percent growth consecutively. Despite high pressure on the import bills due to price hike of crude oil and other essential commodities in international market during 2006-2008, Bangladesh's foreign trade remained at a satisfactory level. The remarkable growth of import-export trade, current account surplus, and continuous increasing trend in the flow of remittance kept the external sector stable. Along with macroeconomic development, Government has also taken pragmatic measures in human resource development and financial institution development to boost up the service sector. Allocations in budget are being made in commensurate with the development strategy and priorities of the commodity trade and service sector.

According to the provisional estimates released by BBS, the highest growth in industry and service sector along with the continued trend of growth in service sector propelled the GDP growth 6.51 percent in FY 2006-07. The rising at export and import trade in FY 2006-07 has been sustained remarkably. There is a continued growth of RMG in the export item despite MFA phase out in December 2004. The export growth of knitwear and woven garments has been achieved at 35.38 percent and 13.50 percent respectively in FY 2005-06 and respectively 19.30 percent and 14.05 percent in FY 2006-07. Total export earning amounted to US$ 10,526.16 million in FY 2005-06, which was 21.63 percent higher than the previous fiscal year's earning of US$ 8,654.52 million. The total export earning for FY 2006-07 amounted to US$ 12,177.86 million, which was 15.69 percent higher than the previous year's earning.

Bangladesh was a strongly inward-looking economy until 1986 when it adopted trade liberalization policies as part of the structural adjustment programme. Bangladesh pursued a gradual approach in its liberalization policies. The policy reform was initiated in an environment of high inflation, large fiscal deficit, and moderate current account deficit. Dr. Nasiruddin Ahmed in his study (2001) showed that during the period of 1992-96 fiscal deficit reduced, inflation rate fell, current account deficit declined, international reserves increased, real effective exchange rate depreciated, and dependence of foreign aid significantly reduced. Bangladesh's experience suggests that macroeconomic stability and trade policy reform can be carried out simultaneously and successfully. Thus Kruger's (1990) assertion that successful trade reform and macro stabilization can proceed in tandem is valid in Bangladesh.

The purpose of this chapter is to show how the appropriate policy measures undertaken by the government enhanced commodity and service trade and eventually boosted the economic growth of Bangladesh.

2.2 Export Promotion Policies in Bangladesh

Government of Bangladesh has adopted various export promotion policies since 1970s to boost up the trade sector aiming at the rapid economic growth. The major export policy reform in Bangladesh aim at providing (i) exporters with unrestricted and duty-free access to imported inputs; (ii) financial incentives in the form of easy access to credit and credit subsidies; (iii) fiscal incentives to exporters which include rebates on income taxes and concessionary duties on imported capital machinery, and (iv) strengthening the institutional framework for export promotion. Thus policy reforms in export sector include trade, exchange rate, monetary and fiscal incentives aimed at increasing effective assistance to exports. Up to 1985 Bangladesh pursued an import substitution strategy with a high-degree of anti-export bias. The introduction of incentives to exporters into such a regime would be viewed as a move toward trade liberalization because it tends to reduce bias against exports. Major export promotion Policies of Bangladesh are as follows:

2.2.1 Export Performance Licensing/Export Performance Benefit Scheme: Government introduced the Export Performance Licensing (XPL) Scheme during the early 1970s in order to strengthen incentives for export-oriented activities. Under the XPL Scheme, exporters of non-traditional products received import licenses (Import Entitlement Certificates-IEC) for specific products over and above their normal percentage allotment based on the f.o.b. value of their exports. Eligible industries and their respective rates of entitlement were specified in the IPO. The coverage of this facility has been extended over time.

In 1986, the XPL Scheme was replaced by the Export Performance Benefit (XPB) Scheme, and the entitlement rates were raised to 40 percent, and 100 percent of the f.o.b. value of exports. Under the XPB Scheme, exporters receive the proceeds from their banks at the time of negotiation of the export documents. An added advantage of the XPB Scheme was that it could be cashed in the secondary exchange market (SEM). With the unification of the dual exchange rates in January 1992, the XPB Scheme has become redundant.[1]

2.2.2 Special Bonded Warehouse Scheme: The system of a special bonded warehouse was first introduced for the readymade garments industries in 1978. This facility exempts exporters from import taxes. Exporters entitled to this facility have the option of choosing the duty drawback system or to avail themselves of a straight authorization to import duty free into established special bonded warehouses. The Scheme is monitored through the use of import and export passbooks and pre-set input-output coefficients. Until 1993, special bonded warehouses were only available to the 100 percent exporters in the garment industries using back-to-back letter of credits, and to suppliers that sell 100 percent of their output to garment exporters. Since 1993, the special bonded warehouse facility has been extended to all 100 percent exporters and 'deemed exporters'. So far, only a few lather and toy exporters have joined the RMG firms that are the main users of the facility. The government recently established a facility for jewellery exporters (World Bank, 1996a).

2.2.3 Duty Drawback system: The notional system of duty drawback was introduced in 1982-83 for certain fast moving items such as readymade garments which enabled exporters to clear imported inputs without actually paying any duty or sales taxes. Item-wise value of imports is recorded and a suspense account for the duties and taxes payable thereon is established. On the production of proof of exports, liability to pay the amounts in the suspense account is removed. Since 1984, drawback payments are being effected through the

[1] The benefit received from the XPB Scheme depended upon the XPB entitlement rate and the difference between the official exchange rate and the Secondary exchange rate. Thus, if for example, the difference between the two exchange rates is 10 percent, a 100 percent XPB on gross export value would produce a benefit equivalent to 10 percent of the f.o.b. value of exports. After the unification of exchange rates, the exchange rate differential has disappeared, and with that the benefit from the XPB Scheme has become zero. Ahmed, Dr. Nasiruddin, *Trade Liberalization in Bangladesh, An Investigation into Trends,* The University Press Limited, Dhaka, Bangladesh.

exporter's bank in the form of a 100 percent interest free advance of the eligible amount of the drawback. From 1988 onwards, the drawback scheme was extended to direct exporters using the inland L/C system. Currently, exporters are able to obtain a drawback on duties and taxes at a flat rate from the bank as soon as the foreign exchange earned from the export is deposited with the dealing bank. The facility of the duty drawback has also been extended to cover deemed exports.[2]

2.2.4 Back-to-Back L/C System[3]: Another export financing facility was introduced for a broader range of export industries in 1987 through the provision of back-to-back L/C system. This system allows an exporter to import raw materials on a deferred payment basis, payments being effected out of proceeds from exports. Until 1986, this facility was available only to readymade garments, specialized textiles and hosiery industries. Since 1986 Bangladesh Bank has allowed a case-by-case authorization of the establishment of such L/Cs in other sectors as well. This facility has also been extended to indirect exporters supplying 100 percent export-oriented industries.

2.3 Financial Incentives

2.3.1 Cash Compensatory Scheme: The Bangladesh Bank administers a cash compensatory scheme with a view to promoting backward linkage. Introduced in 1986, this scheme allowed exporters a cash assistance of 15 percent of the f.o.b. export value. This facility was made available to RMG, hosiery and specialized textiles that are either not covered by or choose not to use the bonded warehouse and duty drawback facilities. The rate of compensation was revised up to 15 percent to 25 percent in 1994. The scheme has become more attractive as gains from duty drawback became less due to lower tariff rates.

2.3.2 Export Credit Guarantee Scheme: In order to insure loans in respect of export finance; an Export Credit Guarantee Scheme (ECGS) was introduced in 1978. This scheme provides exporters with credit at a concessionary rate up to 90 percent of confirmed L/C value. Bank's risk associated with both pre-shipment and post-shipment financing was covered up to 75 percent of the loss. There was also the provision for comprehensive

[2] Local raw materials used as direct input for inputs for export products or products supplied to local projects in foreign exchange against international tender are regarded as 'deemed exports'. Ahmed, Dr. Nasiruddin, *Trade Liberalization in Bangladesh, An Investigation into Trends,* The University Press Limited, Dhaka, Bangladesh.

[3] Back-to-Back letters of credit (L/C) consist of import L/Cs for importing inputs, whose primary collateral is the export L/C, and which is paid out of the proceeds of exports.

guarantee directly to exporters. The public sector insurance body Shadharan Bima Corporation administers the scheme.

2.3.3 Export Promotion Fund: The export promotion fund provides exporters of new and non-traditional items with venture capital on easy terms at lower rate of interest and also provides assistance in obtaining foreign technology and consultancy for product development and diversification.

2.3.4 Bank Loan: A bank loan up to 90 percent of the value against irrevocable and confirmed letters of credit/sales agreement is available (Government of Bangladesh, 1998c).

2.4 Fiscal Incentives

Fiscal incentives to exporters include rebates on income taxes and concessionary duties on imported capital machinery. In Bangladesh exporters are offered the following incentives (Government of Bangladesh, 1998c):

i. Concessionary duty is allowed on the import of capital machinery and spare parts for setting up export-oriented industries.[4] For 100 percent export oriented industries, duty free imports of capital machinery are allowed.

ii. The entire export earning from handicrafts and cottage industries is exempted from income taxes. In case of all other industries, proportional income tax rebates on export earnings is given between 30 and 100 percent. Industries, which export 100 percent of their products, are given exemption up to 100 percent.

iii. Facility for importing raw materials is given for manufacturing exportable commodities under banned/restricted list.

iv. Import of specified quantities of duty-free samples for manufacturing exportable products is allowed. The quantity and value of samples is determined jointly by the concerned sponsoring agency and the National Board of Revenue.

v. Export-oriented industries are exempted from paying local taxes (such as municipal taxes).

vi. Industries in Export Processing Zones[5] enjoy (a) tax holiday for 10 years, (b) exemption of income tax on interest on borrowed capital, (c) complete exemption from dividend tax for tax holiday period for foreign nationals, (d) duty-free imports of machinery, raw materials, three motor vehicles, materials for

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[4] In general, export-oriented units are firms 70 percent of whose productions are exported. Such firm can import capital machinery at a concessionary duty rate of 5 percent and, if located in a less developed area of the country at only 2.5 percent duty (Sattar, 1997)

[5] An Export Processing Zone with an improved infrastructure facility was set up in Chittagong in 1984 where both local and foreign investors were allowed to set up 100 percent export-oriented industries. A second Export Processing Zone was set up in Dhaka in 1993. Both the zones are almost full and further expansion of Dhaka zone has been undertaken recently. For an analysis of EPZ for export development in Bangladesh, see Omar and Ansari (1996)

construction of factory buildings, and (e) duty-free export of goods produced in the zones.

2.5 Strengthening the Institutional Framework for Export Promotion

Export Promotion Bureau (EPB) was established in 1977 as a semi-autonomous body with a view to promoting export and improving plans and policies helpful to the private sector. It is administered by a Board of Management with the Minister for Commerce as the ex-officio Chairman and comprising representatives of EPB, government and private sector.

The major functions of EPB are as follows:

i. To help the government in formulating and implementing export policy;
ii. To assist and advise exporters through organizing programmes related to product diversification, product development and product adaptation for expansion of export basket;
iii. To organize marketing missions and buyer-seller meet in cooperation with different exporters' associations in order to find new markets of exportables;
iv. To educate local exporters on the latest technological developments in the arena of product development and marketing, organize seminars, workshops etc. under National Export Training Programe; and
v. To arrange and participate in international trade fairs for displaying Bangladeshi products abroad.

For meeting its expanding activities, the EPB needs to be streamlined. This may be done by simplifying its work procedures, increasing its skilled manpower and imparting training to the staffs so that it can effectively deal with private investors in a liberalized trade regime.

2.6 Trade Policy

The prime objective of the trade policy of Bangladesh is to maintain a favourable balance between exports and imports by adopting export-based development strategy, export diversification, ensuring the availability of raw materials for export-oriented industries and increasing the share of international trade. Starting from the early eighties, Bangladesh has been pursuing liberal trade policy and was able to open the economy to a great extent. With regard to trade liberalization, the government has been pursuing a moderate protective policy only in consideration of certain sensitive areas like public health, security and religious bindings. Simultaneously, more liberal import and export policies and programmes have been adopted including reduction in tariff.

Bangladesh pursued one-year export and import policies in the first half of eighties and two-year policies in the last half of eighties and the first half of nineties. After that, five-year export and import policies (1997-2002) were implemented. After the termination of tenure of these five-year policies, three-year export and import policies (2003-2006) were adopted. Currently, the import and export trade are being guided by new export and import policies (2006-2009), effective from May 14, 2007.

2.7 Import Policy

The new import policy order (2006-2009) has been adopted in conformity with the policies and objectives of market economy with a view to ensuring supply of quality and hygienic commodities to the consumers at right prices. Steps have also been taken to create investment-friendly environment to attract direct foreign investment to promote and development export-oriented industries, and to expand and promote local industries with a view to bringing dynamism in the economy.

Consistent with the principles of the open market economy and the trade liberalization process, there are import restrictions on a few commodities on religious, environmental, health and security grounds. Initially, 60 items were included in the import restriction list of the import policy order (2003-2006). Gradually, restrictions have been withdrawn and eventually, there are only 25 items in the restriction list at present.

Substantial changes have been made in the new Import Policy Order to promote foreign investment, ensuring availability of quality goods to consumers at reasonable prices, develop human resources and create employment opportunities. Included among the significant changes are:

- To establish new industries, provision has been made to open Letter of Credit (LC) without Import Restriction Certificate (IRC) for import of capital machinery and basic spares;
- Make industrial raw materials available at affordable prices and make some raw materials importable so that finished products are available at affordable prices to consumers;
- Provision has been made to import commodities worth of US$ 35 thousand without LC instead of US$ 5 thousand; and
- Facilities have been given to import commodities free of cost on c.i.f. basis in favour of various universities, non-government donor agencies or similar organizations.

Meanwhile, a range of initiatives has been taken under the import policy to make imports easier. Included among them are: Expatriate Bangladeshis can import capital machinery and raw materials in any quantity while foreign investors, as part of the equity share, can import the same on c.i.f. basis, withdrawal of bindings of country of origin for importing industrial raw materials and import of raw materials has been made easier for 100 percent export-oriented industries for the expansion of export industries.

2.7.1 Simplification of Tariff Regime

To simplify the tariff structure, operative and statutory tariff rates have been made equal since FY 2000-01. The number of tariff slabs has also been reduced. Currently, the number of tariff is four including zero. The maximum import duty has been has been reduced gradually and stands at 25 percent. Table 6.1 below depicts the tariff structure from FY 1995-96 to 2006-07:

Table 2.1: Simplification of Tariff Structure

FY	Operative Tariff Rate (%)	Maximum Tariff	Statutory Tariff Rate (%)	Tariff Slab
1995-96	0, 5, 7.5, 15, 22.5, 30, 45, 50	50	15, 30, 60, 100, 150, 300	8
1996-97	0, 2.5, 7.5, 15, 22.5, 30, 45	45	15, 30, 60, 100, 150, 300	7
1997-98	0, 2.5, 5, 7.5, 15, 22.5, 30, 42.5	42.5	15, 30, 60, 100, 150, 300	8
1998-99	0, 5, 7.5, 15, 25, 30, 40	40	15, 30, 60, 100, 150, 300	7
1999-00	0, 5, 15, 25, 37.5	37.5	15, 30, 60, 100, 150, 300	5
2000-01	0, 5, 15, 25, 37.5	37.5	0, 5, 15, 25, 37.5	5
2001-02	0, 5, 15, 25, 37.5	37.5	0, 5, 15, 25, 37.5	5
2002--03	0,7.5, 15, 22.5, 32.5	32.5	0,7.5, 15, 22.5, 32.5	5
2003-04	0,7.5, 15, 22.5, 30	30	0,7.5, 15, 22.5, 30	5
2004-05	0,7.5, 15, 25	25	0,7.5, 15, 25	4
2005-06	0, 6, 13, 25	25	0, 6, 13, 25	4
2006-07	0, 5, 12, 25	25	0, 5, 12, 25	4

Source: National Board of Revenue

2.7.2 Tariff Reduction

The unweighted average rate of protection and import weighted average rate of protection have been reduced gradually and stands at 12.21 percent and 6.95 percent respectively in FY 2006-07. The unweighted and weighted rates of customs duty have been presented in Table 6.2 and Table 6.3 respectively.

Table 2.2: Impact of Tariff Reforms on Average Rate of Customs Duty

FY	Unweighted Average (%)	Import Weighted Average (%)
1995-96	22.3	17.0
1996-97	21.5	18.0
1997-98	20.7	16.0
1998-99	20.3	14.1
1999-00	19.5	13.8
2000-01	18.6	15.1
2001-02	17.13	9.73
2002--03	16.51	12.45
2003-04	15.62	11.48
2004-05	13.54	9.59
2005-06	13.41	8.09
2006-07	12.21	6.95

Source: National Board of Revenue

Table 2.3: Impact of Tariff Reforms on Average of Customs Duty by Type of Commodities

Fiscal Year / Classification	2001-02		2002-03		2003-04		2004-05		20052006		2006-07	
	UW AV	W. AV	UW AV	W. AV	UW AV	W. AV	UW AV	W. AV	UW AV	W. AV	UW AV	W. AV
Primary Goods	20.10	9.43	20.98	11.92	19.90	11.28	17.61	8.99	17.83	6.93	16.58	4.36
Intermediate Goods	15.61	16.18	14.89	15.86	14.44	15.12	12.46	12.72	12.24	9.33	10.55	8.55
Capital Goods	6.97	3.26										
Final Consumer Goods	26.00	13.96										

Source: National Board of Revenue

2.8 Export Policy

The export quota under Multi-Fiber Arrangement (MFA) on textile and clothing has been abolishes since 1 January 2005. As a result, the country is facing tough competition in export trade more than ever before. The situation is further compounded by liberalization of imports and reduction of tariff slabs at a lower level. In order to retain the current growth of export, production capacity of local export-oriented industries have to be enhanced, importance have been given on meeting compliance, quality of products have to be developed and above all, all-out efforts for diversifying our products and markets have to be strengthened. To achieve all these objectives, what is important is to turn comparative advantage to competitive advantage by using our human resources. The objectives and implementation strategies of Export Policy (2006-2009) have been determined after weighing all these elements.

In Export Policy (2006-2009), sectors such as agro-products and agro-processing commodities; light engineering products; shoe and lather products; pharmaceutical products; software and ICT products; and home textiles have been considered as priority sector as part of product diversification. Besides, the following sectors are considered as special development sectors: finished lather products; production and processing of frozen fish; handicrafts; electronics; fresh flowers; jute products; tribal textile products; unfinished diamond; and herbal medicine and herbal plants.

In order to promote export, all incentives including financial and general ones have been provided to the stakeholders to enhance their competitive edge and to successfully meet the challenges of the post-MFA world. Besides, steps are being taken for making the exiting tariff structure time befitting and realistic.

2.9 Projects for Export Development

The Ministry of Commerce has been endeavoring to facilitate technical assistance to improve the quality of products, explore markets, create demand of new products as required in international markets, which is complementary to export expansion policy and strategy and export diversification. The Ministry of Commerce has been implementing 11 technical assistance projects under RADP in FY 2006-07. Total RADP allocation for these projects in FY 2006-07 was Tk. 1176.6 million of which Tk. 52.1 million was GOB portion and Tk. 1151.5 million was project aid portion. The actual expenditure for the projects stood at Tk. 793.5 million, which 82.37 percent of total allocation.

Among the on-going projects, activities are underway in sectors like handicrafts, leather, silk and RMG under the project 'Business Development Services for Private Sector Promotion.' Steps have been taken under a project initiative titled "Business Services Markets Programme in Bangladesh" to provide quality business support services to SMEs and to innovate the ways to remain competitive and efficient in agro-products, plastic, furniture and IT sectors. Under another project titled "Computerization of the office of the Registrar of Joint Stock Companies and Firms". Registrar of the Joint Stock Companies and Firms will be brought under computerized system that will create online facilities for registering firms and companies.

Besides, under the project titled, "Small Project Facilities", programmes have been undertaken to choose and implement 30 small projects on capacity building on trade-related issues, training, review, research on trade-related issues, holding conference, seminar and workshop etc. In the meantime, 27 small projects have been selected, which are financed by European Commission. Activities are underway for human development in trade related aspects under 'Bangladesh Trade Support Programme". Measures have been takes to strengthen corporate governance by developing accounts audit standards and ensure transparency of financial reports in corporate sector under the project "Strengthening Accounting and Audit Standards and Practices in the Corporate Sector". Under the project "Bangladesh Leather Service Centre for Export Development (Phase-1), services have been provided on product design and development, training, quality testing and certification, market information, international promotion and partnership development and financial guidance. Steps will be taken to diversify export commodities, conduct feasibility study on horticulture export and development of packaging industry under the project "Quality Support Export Diversification Programme."

2.10 Activities Related to RMG Sector

After phasing-out of the Multi-Fibre Arrangement (MFA) of trade on textile and clothing, no negative impact has been felt in the sector and also no worker has lost his or her job. Instead, export has increased in the post-MFA period due to adoption of proper strategies by exporters and timely steps taken by the government. Export data for FY 2006-07 reveals that export of knitwear and woven garments registered a growth of 19.30 percent and 14.05 percent respectively compared to the previous fiscal year. In FY 2006-07, exports registered a growth of 37.39 percent in knitwear and 38.25 percent in woven garments.

The government has undertaken various steps for the development of RMG sector considering its contribution to the national income and employment generation. Some of the important steps are:

- Simplification of Commodities Clearance Procedures: Various measures have been undertaken for simplification of 'export-import clearance procedure through computerization and other steps in the ports and customs stations of the country. For example, in order to meet the space constraints of the Chittagong Port, the New Mooring Container Terminal is being built and necessary container handling equipments including adequate number of gantry cranes have been procured.
- Reduction of VAT on Utility Bill: 80 percent VAT on gas bills, 60 percent on water and electricity bill and 100 percent on clearing and forwarding, insurance and shipping bills for export-oriented garments industries have been exempted.
- Reduction of Insurance Premium: About 10 to 30 percent of insurance premium have been reduced from applicable rates for export-oriented ready-made garments industries.
- Loan Rescheduling Facility: Loan rescheduling facility without any down payment has been allowed for export-oriented garments industries in stock lot cases provided the money received from selling of stock lot goods be deposited to the concerned loan account.
- Duty Free Import Facility: Imports of capital machinery for textile and export-oriented RMG sector have been exempted from custom duty. Besides, all kinds of raw materials to be used for export purposes are being allowed to be imported without any duty.
- Continuation of Cash Incentives: The provision of allowing 5 percent cash incentives against export earnings of goods produced from the use of locally made fabrics is also continuing in the current fiscal year.
- Addressing Compliance Issues: To develop work environment and ensure security in the garments sector and to provide rational and legal facilities to garment workers, 'Social Compliance Forum for RMG' has been set up in 2005 in consultation with the concerned stakeholders. The decisions of this forum have been implemented through two issue-based task forces ("Task Force on Labour Welfare in RMG" and "Task Force on Occupational Safety in RMG") and the Compliance Monitoring Cell (CMC) of EPB, which was established to provide secretarial services to the forum.

- Ensuring Facilities to the Workers: A tripartite agreement was signed on 12 July 2006 among owners, workers and the government for ensuring facilities of garment workers. Ten points laid down in the agreement are now being implemented. For this purpose, 15 teams constituted by the Ministry of Labour and Manpower and 13 teams constituted by BGMEA have been working separately. Thirteen teams of the Ministry of Home Affairs are conducting inspections of factories to ensure environmental developments and fire safety of garment factories. Besides, concerned ministries/offices have been working to implement the minimum wage declared by the Wage Board.
- Alternative Employment Generation: Tk. 200 million was allocated in the budget of 2006-07 for the purpose of creating employment through alternative training in different areas if workers lose their jobs due to negative impact in the quota-free regime.
- Set up of Monitoring Committee of Exports: A committee titled 'Export Monitoring Committee' headed by the Secretary, Ministry of Commerce with representatives from Ministry of Shipping, Ministry of Environment and Forest, Finance Division, NBR, Bangladesh Bank and EPB has been formed to deliver suggestions to solve the existing problems in RMG industries. The committee has been playing an important role in resolving the problems arising in this sector.

Besides, several additional steps have been taken for the development of RMG sector. Included among them are:

- Facilities given by the government to continue to reduce the manufacturing costs;
- Provide certain facilities (such as reduction of interest rates on export credits, reduction of Chittagong Port usages charges etc.) for reducing the 'cost of doing business' in the RMG sector;
- Allow 100 percent foreign investment for establishing RMG industries in the Export Processing Zone (EPZ) area;
- Provide 'One Stop Service' by the Board of Investment to encourage Foreign Direct Investment (FDI);
- Continue the government efforts to address compliance issues in the RMG sector;
- Continue lobbying for passing the 'Tariff Relief Assistance for Developing Economies (TRADE) Act of 2005' in the US Congress for obtaining duty-free market for LDC products in USA;
- Organize trade fairs (single and joint) abroad under the initiatives of Export Promotion Bureau (EPB) for increasing exports;
- Resume yarn import through land ports;
- Keep on putting unrelenting efforts for solving the existing problems of RMG sector;
- Strive to achieve export targets through the commercial wings of Bangladesh Missions abroad;
- Continue the government efforts for the inclusion of RMG in the list of 97 percent product declared in the Hong Kong WTO Ministerial 2005 for allowing duty-free market access of LDCs;
- Make efforts for having exports at concessionary duty rates in the countries where duty-free market access has yet to be received; and
- Increase the facilities for local and foreign investors for establishing forward and backward linkage industries.

2.11 Free Trade Agreements

Since the establishment of WTO on 1 January 1995, Bangladesh has been playing an active role in the ongoing WTO negotiations with a view to protecting a legitimate claim and interests of LDCs in an extremely competitive global trading environment. Bangladesh also attaches equal importance to its bilateral and regional trade. In the context of bilateral trade, Bangladesh already held preliminary discussions on possible bilateral FTAs with India, Pakistan, and Sri Lanka. Nepal and Bhutan are also interested in having bilateral FTAs with Bangladesh. Bangladesh is a member of a number of RTAs including SAFTA. Some of the RTAs are discussed below:

2.11.1 South Asian Free Trade Area (SAFTA)

At the 12th SAARC Summit held in Islamabad during 4-6 January 2004, member states signed an agreement on South Asian Free Trade Area (SAFTA) to promote and enhance mutual trade and economic co-operation. The agreement came into force on January 1, 2006 with the ratification of all member countries after completion of formalities. The covers only trade in goods. In the agreement, provisions have been made for the sensitive list of the products outside tariff reduction, trade liberalization programme, dispute settlement procedures, rules of origin, institutional arrangements, safeguard measures, areas for technical assistance for LDC member countries for tariff reduction.

Tariff reduction under SAFTA has commenced from 1 July 2006. Under the agreement, developing member states (India, Pakistan and Sri Lanka) will reduce tariffs on 0-5 percent for commodities excluding the items of respective sensitive lists for LDC ember states by 2009. On the other hand, Bangladesh and other LDC member states will reduce tariffs to 0-5 percent of commodities excluding the items of respective sensitive lists by 2016. A total of 1,254 commodities have been included in the Bangladesh's sensitive list in view of protecting the country's agriculture and industries and also in the context of revenue earning. On the other hand, 744 commodities have been included in the sensitive list of India, 1,191 in Pakistan's list, 1,067 commodities in Sri Lanka's list, 157 commodities in Bhutan's list, 671 commodities in Maldives's list and 1,313 commodities in Nepal's sensitive list.

All the SAARC member states have issues necessary notifications to come in to force the tariff concessions as per the commitment made by SAFTA Arrangement. As on March 2007, Bangladesh has given 5 percent tariff preferences to the all SAARC countries reduction facilities, which will be increased to 10 percent on 1 January 2008. On the other hand, Pakistan and Sri Lanka are providing tariff preference at 40 percent to LDCs member states, which has been enhanced to 70 percent from 1 January 2008. India is providing tariff preferences to LDCs member states at 33.33 percent, which has been increased to 66.66 percent from 1 July 2007. Besides, India would provide tariff free access for eight million pieces of Bangladeshi garments, which is under consideration.

2.11.2 Asia Pacific Trade Agreement (APTA)

The Bangkok Agreement was established in 1975. Member countries of this trading block are Bangladesh, India, Sri Lanka, China, the Republic of Korea and Lao People's Democratic Republic. The Bangkok Agreement has been revised and renamed as the Asia Pacific Trade Agreement (APTA).

The participating countries of this agreement have concluded three rounds of trade negotiations. The first round of trade negotiations was concluded in 1980 and the second round in 1990. The third round of trade negotiations was launched in 2001 and completed in 2004. The APTA has come into force from 1 July 2006. The APTA contains consolidated list of tariff concessions granted by member countries to each other. Under this agreement, China has provided 100 percent tariff concessions to 83 items of Bangladesh at 8-digit level and republic of Korea has provided 100 percent tariff concessions 10 139 items at 10-digit level.

2.11.3 The Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation (BIMSTEC)

The BIMSTEC Framework Agreement on FTA was concluded in February 2004. Member countries of this block are Bangladesh, India, Myanmar, Sri Lanka, Thailand, Nepal and Bhutan. An agreement on trade in goods, trade in services and investment has been incorporated in this Framework Agreement. A Trade Negotiating Committee (TNC) has been constituted to conduct negotiations.

Under the BIMSTEC, two approaches; namely First Track and Normal Track would be adopted to implement the tariff reduction process. Under the First Track products, non-LDCs (India, Sri Lanka and Thailand) would complete tariff reduction process for LDCs (Bangladesh, Myanmar, Bhutan and Nepal) on the selected items in one year and LDCs would do the same for non-LDCs in three years. On the other hand, LDCs would complete tariff reduction process on the First Track products in five years for non-LDCs and three years for LDCs. For Normal Track products, non-LDCs would complete tariff reduction process for LDCs in three years and for non-LDCs in five years. On the other hand, LDCs would complete tariff reduction process for non-LDCs on Normal Track products in ten years and for LDCs in six years. The BIMSTEC FTA on trade in goods came into force from 1 July 2006.

CHAPTER III
CURRENT SCENARIO OF IMPORT-EXPORT OF BANGLADESH

3.1 Current Scenario

Because of the ongoing global financial crisis, by all counts the year 2009 is going to be a bumpy ride for all countries- high, middle and low income, large and small, North and South. The related discourse with regard to the crisis has now shifted from 'where it all did originated' and 'who were the main responsible' to 'what are the possible consequences' and 'how the adverse impacts should be best addressed'. A common refrain, often repeated and widely circulated, is that things will get worse before they start to get better. Experts tend to agree that the recession will continue and deepen in 2009, and possibly stabilize in early 2010, to be followed by recovery, which will perhaps kick start only towards the end of 2010. Across the globe, from USA to Germany, and from China and India to Singapore to Malaysia, countries are preparing to negotiate and navigate the turbulent waters in 2009.

To address the attendant challenges, developed and emerging economies have by now set in motion various initiatives in the form of bailout measures and stimulus packages. The objectives of such initiatives appear to be five-fold: (a) to stimulate domestic demand, (b) to create new jobs, (c) to stabilize financial markets, (d) to support domestic industries, and (e) to safeguard export interests. In view of the above, it is only pertinent to ask how the recession and the consequent adverse affects, as also the wide-ranging response-measures taken by partner countries, are going to impact on the overall macroeconomic performance, price level, domestic industries, exports of goods and services as also the balance of payment position as low income economies such as Bangladesh. How the current crisis will impact the above mentioned performance indicators during the current fiscal year and over the next and which policies Bangladesh should pursue in this regard are important questions that merit serious and urgent attention to the policymakers.

Bangladesh's increasing integration with the global economy through trade in goods and services is a measure of the potential impact that the ongoing crisis could have on the economy. However, until now Bangladesh has been spared the worst consequences of the ongoing crisis. When the early signals started to blip on the radar screen in 2008, Bangladesh Bank took speedy and vigorous steps to safeguard the country's reserves. Since foreign portfolio investment accounted for less than three percent of market capitalization in

Bangladesh, her capital market did not witness the sort of volatility that was experienced by stock markets world over including those of the neighbouring India. With hindsight, it also proved to be a blessing in guise that the Stock Exchange Commission (SEC) and the Bangladesh Bank did not succumb to pressure by various quarter to allow trading exotic but toxic derivatives in the country's share market i.e. Bangladesh did not go for capital market convertibility of her currency also proved to be a saving grace. During the first six months of FY 2008-09 (July-December, 2008) export from Bangladesh posted a growth of 19.4 percent over the corresponding period of FY 2007-08; remittance flow during the same period registered a growth of about 31 percent. The fall in the price of food, fertilizer and fuel eased the burden of import payments, growth of which is expected to decelerate further in near future. This is likely to lead to some improvement in the balance of payments situation over the coming months. Some deceleration in inflation, particularly food inflation, is already visible. Bangladesh Bank's projections about GDP growth for FY 2008-09 with its low case of 6.3 percent and high case of 6.6 percent appear to be realistic and attainable. A close look at various recent trends concerning some macroeconomic and sectoral indicators of Bangladesh economy transmits some cautionary notes.

Export growth over the first two quarter, as mentioned above, was a robust 19.3 percent. However, as a matter of fact, in the second quarter of FY 2008-09 (October-December) the growth had indeed been negative, at –1.4 percent. This is something, which is unusual in recent years (export growth rate in months of October, November and December, 2008 were 7.4 percent, 13.5 percent and –10.0 percent respectively when compared with corresponding months of FY 2007-08). This closely reflects the trend in export of apparels, the dominant item in the export basket, over the same period. The July-November export growth has been in the negative territory for several of Bangladesh's non-apparel items: growth of export of Jute and Jute goods were –6.8 percent and –12.5 percent respectively; export of engineering products was –3.1 percent. Export of leather products is more dismal, which is –17.9 percent. The emerging ship-building industry, which received an export order of about US$ 400 million in recent years, is also experiencing difficulty at present. It is to be noted that many of Bangladesh's developed trading partner countries that account for most of Bangladesh's exports of goods and a large part of export of services (remittance), are now in recession officially. The US economy, which accounts for 25.5 percent of Bangladesh's global export of goods and 17.4 percent of remittance is projected to experience negative growth of –0.7 percent in 2009. The 42 years old Consumer Confidence Index (CCI) is at its lowest. On the other hand, growth projection is –0.5 in 2009 for Euro-area countries. It is also be noted in this connection that world trade which registered a rise of 4 percent in real terms in 2008 is projected, according to the World Bank estimate, to experience a negative growth of 2 percent during 2009, a first time in recent history.

Bangladeshi exporters have been able to sustain their market share by offering discounts, tolerating, in many instances, order deferment and cancellations, and by taking significant cuts in profit margins. Currency devaluation in competing countries such as India, Sri Lanka, Pakistan, to the extent of 10-40 percent over the recent years, have also undermined competitive strength of Bangladeshi products, including apparels, whilst Bangladesh Taka (BDT) has held steady over the past one year, depreciating only by 0.6 percent between January 2008 and January, 2009. It is to be recalled here that the 75 percent cap on growth of Chinese export of apparels to the US market has been lifted recently, as of January 1, 2009. China has also recently reversed a number of measures, which were aimed at encouraging producers to move up market (e.g. tax on lower end products). Exports of low-end apparels from Bangladesh had earlier benefited from such policies.

Stimulus packages designed in support of producers and exporters in India and China will also start to have impact on Bangladesh's competitiveness in the global market. Recently India has designed a plan to inject US$ 4.5 billion in the financial system to help exporters, with the Reserve Bank of India adding another US$1.3 billion through a refinance operation. In November, 2008 China announced a package of capita spending plus income and consumption support measures to the tune of US$ 546.0 billion. Bangladesh's backward linkage spinning sector, with an investment of about 27,000 crore taka, has already made its case as regards their weakened competitive strength vis-à-vis imported Indian yarn in view of the new price dynamics. The price of 30 count yarn has now become 30-40 cents higher in Bangladesh compared to what is offered by Indian exporters. Knitwear sector and spinning sub-sectors are likely suffer most because of the emergent situation. The data show that in October of FY 2008-09, growth of import duties was lower (-1.7 percent) compared to corresponding month of FY 2007-08 (growth of total import related duties was +6.6 percent), whilst the November figure indicates a further dip (-10.0 percent and –0.5 percent respectively). The December figure are rather alarming with the two corresponding figures being –12.2 percent and –13.9 percent (in the backdrop of falling VAT duties of –19.7 percent. As a result, revenue mobilization targets are likely to be missed in FY2008-09. Over the last two years, in 2007 and 2008, a record number of Bangladeshi workers (1.7 million) had left the country in search of jobs abroad. In 2009, in all likelihood, the number of workers going abroad will be significantly lower, also particularly because some of the new destinations including those such as UAE, Malaysia and Singapore have indicated caution in the face of sluggish economic growth and lower demand for construction and other services. Saudi Arabia and Kuwait have already instructed their embassies in Dhaka not to issue worker's visa. Although no reliable estimates are available with regard to returning migrant workers, anecdotal evidence suggests the need for attention to this issue as well.

3.2 Crisis as an Opportunity

Every crisis creates opportunities for those few who are willing and prepared to look for and realize the potential benefits. In spite of the adverse impacts and potential dangers, there are some encouraging signs which Bangladesh should seize on and try to make work to her advantage. Major buyers from Japan, a market worth about US$ 22.6 billion imported apparels (Bangladesh account for only about 29.6 million out of this, about 0.13 percent) have started to show renewed interest to source from Bangladesh, by diverting imports from other countries(mainly from China). The adverse affect of recession, pressure to appreciate the Yuan (appreciation of 5.2 percent over the last one year), wage rates that are about 2-3 times higher than Bangladesh (though productivity is higher in China) make Bangladesh an attractive destination for major buyers of apparels in spite of China's dominant presence in the global market. For example, only Vietnam's performance (16.9 percent growth during July-November, 2008) is comparable to Bangladesh's record (15.7 percent) in the US market. Indeed, Bangladesh's strategy in these times of recession and falling global apparels demand should be to go for higher share in a shrinking pie by making best use of the emerging opportunities.

3.3 Policy Recommendation

A multi-stakeholder committee will be constituted to provide recommendation to the government in view of the emerging crisis in consultation with the private sector and exporters. The committee will be assigned to review the development continuously and to provide appropriate policy inputs to the government for speedy decision-making. Recently Bangladesh bank has announced monetary policy that evinces sensitivity to possible adverse impact to our economy. To take advantage of the emerging opportunities, Bangladesh will need to devise appropriate policies to create adequate incentives to encourage domestic entrepreneurs and to attract foreign investors. Policy makers could consider the idea of creating an export-stimulus fund to support entrepreneurs and export business. Such fund could be used to provide credit at lower rates, encourage acquisition and adoption of new technologies and promote R&D and product diversification at enterprise level. Such a fund could also be used to support entrepreneurs who are interested to set up common services such as effluent treatment plants, skill up-gradation and dyeing facilities in the industrial clusters that are growing up around the Dhaka city and also in the proposed economic zones. This fund could also be used in support of initiatives for workers (e.g. government could take an initiative to build dormitories for workers in such industrial clusters). To stimulate productivity, a technology upgradation fund could also e set up (such a fund, in support of jute and textile sector, has been in place in India for several years).

Given the emerging situation and in view of the interests of the potential investors to invest in Bangladesh, all efforts need to be steered towards creating a conducive business and investment environment in the country. Required investments will also need to be made to enhance the capacity and facilities provided by Export Processing Zones (EPZs) and Specialized Investment Zones (SIZs). The suggested export-support fund could be used for this purpose. It is to be reckoned that at times like these whilst investors tend to be cautious; they also are on the look out for new and safe FDI and portfolio investment opportunities.

3.4 Conclusion

Bangladesh's relative insulation from global capital market and heavy dependence on lower-end exports of goods and services has provided some caution to the economy. But there is no room for complacency. As the above discussions would suggest, Bangladesh will need to be on the alert. We must examine closely the recent trends, identify the disquieting developments and undertake appropriate initiatives and measures to address the attendant challenges originating from the on-going crisis and try to take advantage of the emerging opportunities.

CHAPTER IV

IMPACT OF TRADE LIBERALIZATION ON ECONOMICPERFORMANCE OF BANGLADESH

4.1 Introduction

After its independence in 1971, Bangladesh followed an import substitution industrialization strategy. Trade policies were characterized by high import tariffs, quantitative restrictions, foreign exchange rationing, and an overvalued exchange rate. The core objectives of this inward-looking development strategy were to (i) protect the infant industries of the country, (ii) lessen the balance of payments deficit, (iii) ensure efficient use of the available foreign exchange, (iv) protect the economy from international capital market and exchange rate shocks, (v) reduce fiscal imbalance, and (vi) achieve higher economic growth and 'self-sufficiency' of the nation.[6] But it was failed to produce the desired outcomes. The macroeconomic scenario in terms of growth of Gross Domestic Product (GDP) and manufacturing output, foreign debts, fiscal and current account deficits, and the stability of general price level was not satisfactory.[7] Bangladesh, in effect has undertaken strategies leading to a greater market and export-orientation by initiating the Structural Adjustment Programmes (SAP) in different spheres of the economy as recommended by the World Bank and the International Monetary Fund (IMF) in 1982.[8]

Thus Bangladesh initiated the process of trade liberalization in the early 1980s, with an objective, inter alias, to eliminate the anti-export bias of past protectionist policies and hence enhance the economy's export performance as well as its overall efficiency in resource allocation.[9] This process has gained a high degree of momentum since the beginning of 1990s, by the abolishment of quantitative restrictions (QRs) and a drastic reduction in the

[6] See Government of Bangladesh (2004).
[7] See Hossain and Alauddin (2005).
[8] Ibid
[9] See Ahmed (2001)

tariff rates. Simultaneously, a number of policy reforms were carried out to provide adequate incentives to the export sector of the country as well as foreign investors. This chapter provides a review of trade liberalization and other accompanying policy measures undertaken in Bangladesh.

By any measure of openness- size of trade, removal of QRs, lowering of tariffs, black market premium of foreign exchange- the economy of Bangladesh is much more open than it was in the 1980s.[10] However, the impact of trade liberalization on economic performance of the country appears to be mixed: an improved, but not strong enough growth performance; the expansion of trade, but without adequate diversification; a reduction of poverty, but an increase in income inequality.[11] This chapter examines the effect of trade liberalization on Bangladesh's economic performance.

4.2 Increased Degree of Openness of the Economy

As the restrictions on both imports and exports were being removed, the economy of Bangladesh became increasingly open to the world. The increasing openness of the economy is reflected by the dramatic increase of the trade-GDP ratio of Bangladesh in the 1990s. In 1990 trade-GDP ratio was only 26.7 per cent which increased to 42.1 per cent in 2000. The Import Penetration and Export Propensity- often regarded as an important indicators of liberalization- also increased from 16.7 per cent and 8.3 per cent to 23.0 per cent and 17.5 per cent respectively during the same period.

[10] See World Bank (1999)
[11] See Rahman (2006)

It is also evident that trade-GDP ratio of Bangladesh has increased more rapidly than other South Asian countries from 1990 to 2000, which again reflects that the degree of international openness of the economy in Bangladesh has been faster than its neighbours. The contribution to the country's increased openness came primarily from export, as Bangladesh's export growth, relative to GDP, was considerably higher than that of some other South Asian Countries.[12]

4.3 The Trend and Changing Pattern of Exports

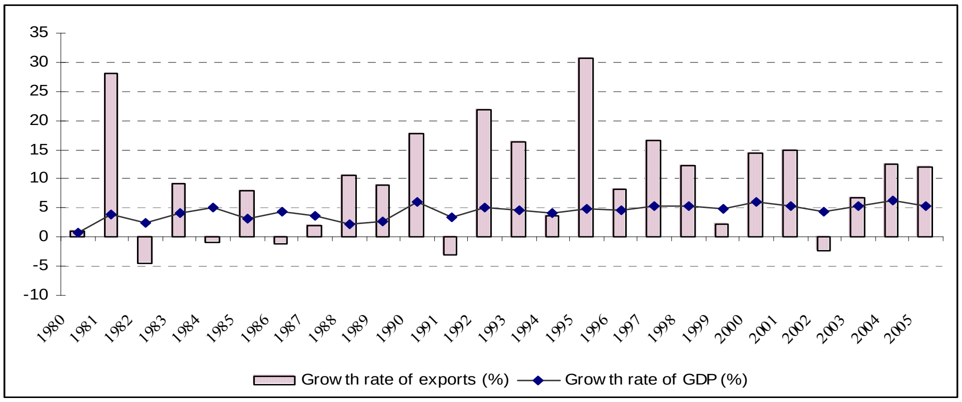
4.3.1 Growth in Exports

Since the implementation of openness policy in the early 1980s, external sector has played a more important role in Bangladesh's economy. The phasing out of the QRs, reductions in tariff levels and consolidation of the tariff rates structure as well as the shift in the exchange rate policy appear to have been conducive to the development of exports.[13] In the beginning of the 1980s total exports of Bangladesh stood at US$ 0.99 billion, which increased to US$ 1.84 billion in 1990 and further increased to US$ 6.58 billion and US$ 9.63 billion in 2000 and 2005 respectively. The annual average growth of real exports in the 1980s was 6.10 percent which was higher than the real GDP growth rate of 3.21 percent. However, it was in the 1990s when the country experienced growth of real exports at a rate much higher than GDP: 12.64 vis-à-vis 4.80 percent. This is reflected in Figure 4.1, which shows that while in the 1980s the real export growth rates have been fluctuating around the GDP growth rates, for most of the 1990s export growth rates have exceeded growth rate of GDP. In other words, in the post-liberalization period the development of exports was remarkable and the importance of foreign trade sector in Bangladesh's economy had been increasing. The relatively high growth of exports in the 1990s had also resulted in a growing share of exports

[12] See Government of Bangladesh (2003)
[13] See Hossain and Alauddin (2005).

in GDP. In the 1980s the export-GDP ratio was lower than 6 per cent, which grew rapidly in the 1990s and reached to 16.06 per cent in 2005.

Figure 4.1: Growth of Real Exports and GDP in Bangladesh



4.3.2 The Changing Structure of Bangladesh's Exports

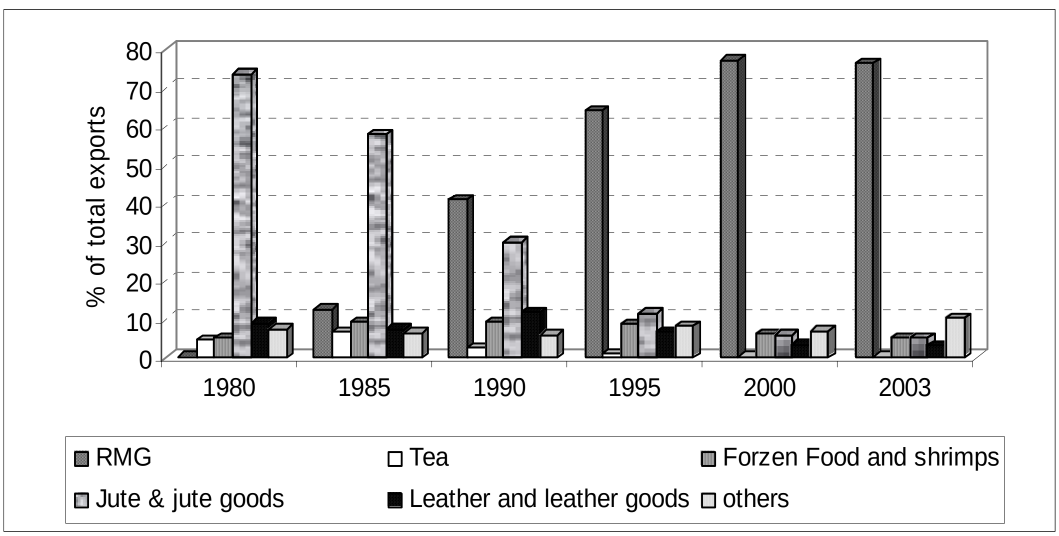
Over the last two decades, there has been a dramatic change in the structure of Bangladesh's exports. To a large extent this change is caused by, and reflects, the changing structure of output as percentage of GDP where the contribution of traditional agricultural sector is decreasing and that of service and industry is increasing.[14] While the production share of agriculture as percentage of GDP has declined from 31.55 per cent in 1980 to 20.50 per cent in 2005, share of industry and services have increased from 20.63 per cent and 47.81 per cent respectively to 28 per cent and 21.50 per cent respectively during the same period.

The most significant change in Bangladesh's exports is that there has been a clear shift from primary commodities exports to manufactures exports in the 1990s. The share of primary goods exports in total merchandise exports declined from 32.35 per cent to 7.49 per cent in 2005 while that of manufactures exports increased from 67.64 per cent to 92.50 per cent over the same period. With the growth of the share of manufacturing exports, the composition of total exports has also experienced significant changes. Before the trade

[14] See Mohiuddin and Hasan (2005).

reform, Bangladesh's exports were dominated by jute goods, leather and leather products, raw jute and tea. In the 1990s the relative significance of all major exports was squeezed at the expense of the rapidly rising share of ready made garments (RMG). It might seem somewhat surprising that between in the decade of the 1990s exports of RMG increased more than 6 fold and it was possible among others due to the Multi-Fibre Agreement (MFA) quotas and Generalized System of Preferences (GSP) facilities provided by the United States of America (USA) and European Union (EU) to Bangladesh. It can be seen from Figure 4.2 that the share of RMG in total exports increased to about 76 per cent in 2003 from almost negligible share of 0.1 per cent in 1980, while that of jute and jute goods fell from about 74 per cent to a almost 5 per cent during the same period. This reflects that the country's exports are not diversified, rather concentrated on few products, especially on garments, which consider as a major weakness of the export sector of Bangladesh.

Figure 4.2: Structural Changes in the Composition of Export Basket



Source: Government of Bangladesh (2004)

4.3.3 The Role of EPZs in Bangladesh's Exports

An important development in the developing countries in the 1970s and 1980s was the creation of export processing zones (EPZs), specialized industrial estates designated to produce mainly for export with duty free entry of raw materials and tax free exports of finished goods.[15] EPZs are widely recognized as a key institution in export-led growth strategies in these countries whose several decades of inward looking strategy was not able to solve the basic economic problem of unemployment and poor economic growth.[16] In the 1980s one of the most significant policies of the reform in Bangladesh was the establishment of EPZs which aimed at attracting foreign investment, increasing foreign earnings, rapid industrialization, employment generation and technology transfer by boosting up export. Subsequently, Bangladesh has achieved astonishing export success through EPZs.

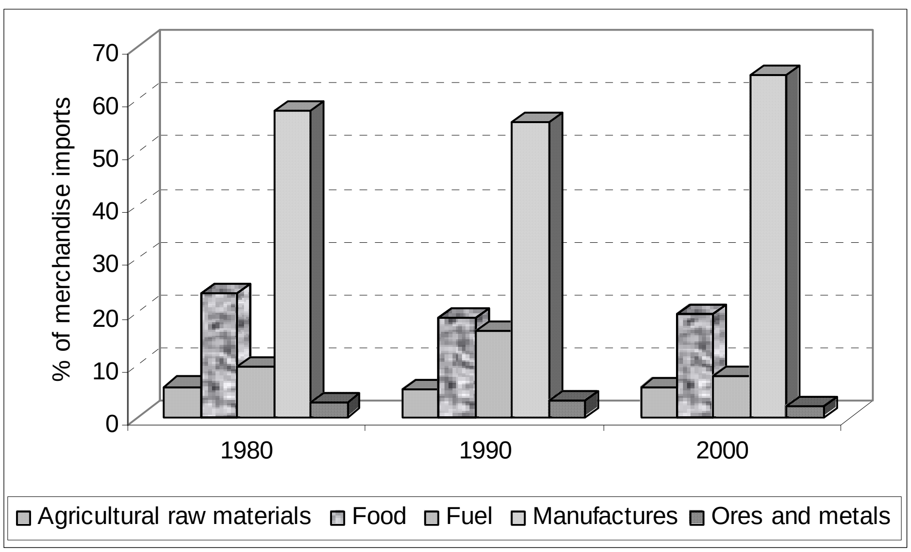
The share of EPZs in total exports increased from almost a negligible amount of 0.02 per cent in 1983-84 to a spectacular high of 16.07 per cent in 2004-05. The annual average growth rate of export earnings of the EPZs has been more than six times higher than that of total national exports earnings and more than four times higher than that of total national export earnings from manufactured goods.[17] Thus export performance of EPZs is much more impressive than that of the country as a whole.

[15] See Dowla (1997).
[16] Ibid
[17] See Hossain (2006).

4.4 The Trend of Imports

The growth of imports in Bangladesh has also undergone significant change during the last two decades. Like exports, total imports of the country was recorded a tremendous growth, increasing from US$3.23 billion in 1980 to US$9.05 billion and US$13.54 billion in 2000 and 2005 respectively. However, with the increase in the total imports, there has not been much change in the composition of imported goods. As Figure 4.3 reveals, the share of manufactures imports in total merchandise imports increased from 57.87 per cent in 1980 to 64.50 per cent in 2000, while that of agricultural raw materials, and ores and metals remained more or less constant during the same period. The share of fuel increased significantly between 1980 and 1990 but fell dramatically thereafter. On the other hand, the share of food imports decreased steadily from 23.62 per cent in 1980 to 19.69 per cent in 2000, indicating

Figure 4.3: Structural Changes in the Composition of Imported Goods



Source: Estimated from World Bank (2006) data

reduction in the gap of domestic production and total food requirements. Food production in Bangladesh has increased significantly over the years from 13.24 million metric tons in 1980-

81 to 23.79 million metric tons in 2000-01.[18] Thus Bangladesh has been able to reduce its chronic food shortages in the post liberalization period, although occasional and localized food shortages have been occurred due to the natural disasters and inefficiencies in food distribution.[19]

4.5 Changes in Overall Macroeconomic Performance

A comparison between 1980s and 1990s shows that the economy of Bangladesh experienced moderately accelerated growth in the 1990s compared to the previous decades. The annual average GDP growth rate increased from 3.72 per cent in the 1980s to 4.80 per cent in the 1990s and exceeded an annual average rate of 5 per cent during the first five years of the present decade. The accelerated GDP growth rate, coupled with falling population-growth rate (1.90 per cent for 2001-05 as against 2.14 per cent and 2.36 per cent in the 1980s and 1990s), led to an increase in the per capita GDP growth. The per capita GDP growth accelerated to 2.58 per cent in the 1990s and moved to 3.33 per cent in 2001-05.

Sectoral GDP growth rates in agriculture, industry and services seem to have responded favourably in the liberalization period. The annual average growth of agricultural GDP accelerated from 2.54 per cent in 1980s to 3.22 per cent in the 1990s; industrial GDP accelerated from 5.78 per cent to 6.95 per cent and the service sector GDP from 3.70 per cent to 4.48 per cent over the same period. However, during the first five years (2001-05) after the 1990s, agricultural GDP declined to 2.12 per cent while industrial and service sector GDP moved to 7.46 per cent and 5.62 per cent respectively. Within agriculture, the average annual growth in crop production decreased from 2.69 per cent in 1980s to 1.72 per cent in the 1990s, despite liberalized imports of agricultural equipment since late 1980s. This may

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[18] See Government of Bangladesh (2007)
[19] See Rahman (2006)

happened due to the unexploited potential for higher agricultural growth through crop diversification, especially through shift to high-value crops.[20]

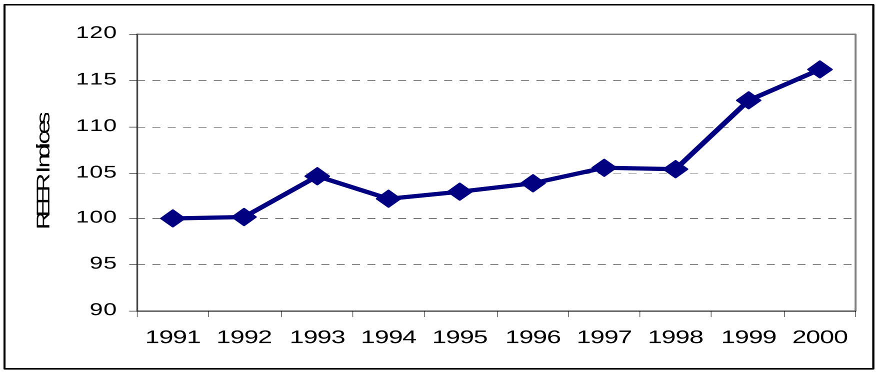
The growth in large-scale manufacturing reached to 6.90 per cent in the 1990s, which has led almost singularly by the ready-made garment industry. The national income estimates of manufacturing value-addition by sector show that between 1991-92 and 1999-2000 the growth of medium and large-scale manufacturing grew at 7 per cent annually; but at only 4.3 per cent excluding garment industry.[21] Since the ready-made garment (RMG) industry is labour intensive, the employment growth in this sector is praiseworthy. From 200,000 workers in 1985-86, the RMG sector now directly employs 1.8 million workers-almost 90 per cent of them are women-in its 3600 factories.[22] But it also shows that the economy has moved away rather than moving towards having a more diversified manufacturing base.[23]

There have been some improvements over time in the gross savings and investment easing the budgetary constraints and marked improvement in foreign exchange reserve. However, there have been persistent savings and investment gaps over the whole period which points to the structural weakness of the economy. The rate of inflation steadily declined throughout the years especially during the 1990s when it averaged to 3.64 per cent compared to 9.52 per cent during the previous decade. This helps the economy to preserve the competitiveness of the exchange rate. The Real Effective Exchange Rate (REER), another important indicator of competitiveness, was stable for most of the 1990s, though since 1998

[20] See Mahmud (2003)
[21] Ibid
[22] See Ahmed and Sattar (2004)
[23] See Mahmud (2003)

REER has devalued sharply in order to use the exchange rate as a policy tool to promote trade.[24]

Figure 4.4: Real Effective Exchange Rate in the 1990s



Source: Data for this figure have been taken from Rahman (2006).

4.6 Changes in Poverty and Income Inequality

Bangladesh has achieved notable progress in income-poverty reduction since the beginning of the 1990s. The headcount index of poverty declined from 58.8 per cent in 1991-92 to 49.8 per cent in 2000, indicating a modest reduction in the incidence of national poverty by 1 percentage point per annum. It is also evident that progress of reducing the headcount index was better in urban areas while rural areas presented better progress in reducing the depth and severity of poverty as captured by trends in poverty gap and squared poverty gap respectively. On the other hand, the income inequality in Bangladesh increased harshly, in spite of improved growth during the 1990s. The Gini coefficient increased significantly from 25.9 per cent in 1991-92 to 30.6 per cent in 2000, with urban inequality rising much more than rural inequality. The level of consumption expenditure inequality rose from 30.7 to 36.8 per cent in urban areas and from 24.3 to 27.1 per cent in rural areas between 1991-92 and 2000. Moreover, over the same period national income attributable to the poorest 10 per cent of the population declined from a proportion of 2.58 per cent to 1.84 per cent, while the control on the national income by the richest 10 per cent of the population increased from

[24] See Rahman (2006)

29.23 per cent to 40.72 per cent. In other words, the income differential between the poorest and the richest increased from about 15.50 times to more than 22 times during the 1990s.

4.7 Conclusions

The implication of trade liberalization programmes in Bangladesh has been reflected in the country's robust performance of the export sector. But the export growth is overwhelmingly dominated by the dynamism in RMG sector alone, international trade in which had been governed by MFA quotas limiting competition and providing a reserved market for the country. But the abolishment of MFA quotas brings the greater competition in the global garment market and thus it will be challenging and difficult for Bangladesh to maintain high growths in the RMG exports in the post-MFA period. Bangladesh's exports are also concentrated on few destinations, mainly on USA and EU. For example, 25.6 per cent and 58.4 per cent of total merchandise exports of Bangladesh went to USA and EU respectively in 2003-04. Hence, the country needs to diversify its export market by finding new export destinations. Bangladesh also needs to give more attention to its physical infrastructure, governance, and the financial system of the country in order to acquire more benefits of the globalization and to accelerate growth and reduce inequality and poverty.

CHAPTER V

PRE & POST MFA RMG SECTOR- TREND ANALYSIS, EMPLOYMENT SCENARIO

5.1 Introduction

There has been a great debate on the structural changes to be taken place in the global textiles and apparels market after the phasing out of Multi-fibre Arrangement (MFA) by December 2004. In January 2005 the World Trade Organization (WTO) Agreement on Textiles and Clothing (ATC) has reintegrated all textile and clothing products to the Most Favoured Nations (MFN) principles of the WTO. The ATC has eliminated all quotas, which have been applied for last 40 years by the industrialized countries to their textiles and clothing imports from developing countries ever since the MFA was instituted in 1974. There has been a considerable debate about the possible implications of the removal of quotas under ATC, for the external sector as well as for the overall economy of the textile and apparel exporting developing countries.[25]

Ready-made garment (RMG) exports have been a major source of foreign exchange earnings as well as employment of two million work forces in Bangladesh. Several studies relating to the post-MFA environment including those of IMF, WTO and World Bank predicted that after MFA phase-out prices of textiles and garments in the international market will fall and cost of material inputs for ready made garments will increase for which Bangladesh will lose the export advantage it has enjoyed over its competitors during quota regime. In the document published by the Government of Bangladesh (PRSP-2004), it has been stated that, "after MFA phase out exports from Bangladesh could fall by as much as 50 per cent, GDP volume by 2.3 percent, and employment by 13 per cent." However, in reality it reveals a mixed picture. In this backdrop, this chapter analyses the role of RMG sector in the total

[25] See Hertel et al. (1996), Hartel and Martin (2000), Yang, Martin, and Yanagishima (1997).

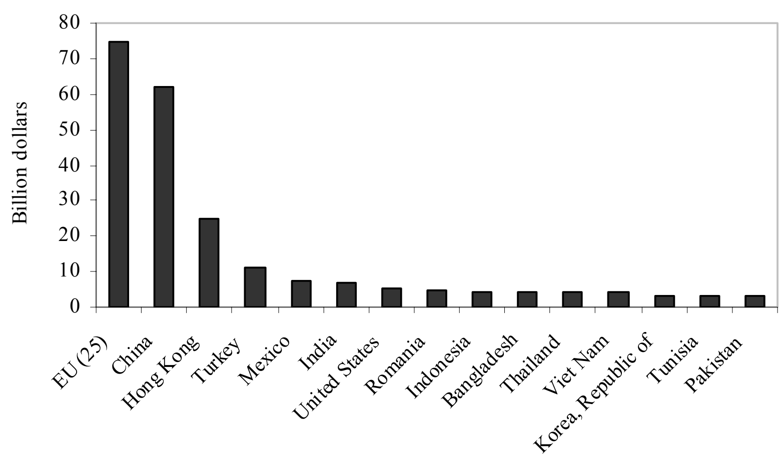
exports of Bangladesh in both the MFA and post MFA regime and identifies post MFA challenges of the country.

5.2 The Role of RMG Industry in Bangladesh's Exports

5.2.1 Progress in the MFA Regime

Within the MFA regime Bangladesh has emerged as one of the leading manufacturer and exporter of RMG to the world market. Exports from the RMG sector of Bangladesh grew from US$ 0.84 billion in FY1991 to US$ 4.44 billion in FY2004. This represents a fivefold increase with an exceptional annual average growth rate of 17.95 per cent over the past one and half decade and Bangladesh has become one of the largest RMG exporting countries in the world market (Figure 5.1). In FY2004, the RMG industry contributed to 76.6 per cent of total export earnings and accounted for 9.5 per cent of country's GDP and 29.7 per cent of the manufacturing GDP.[26]

Figure 5.1: Leading Exporters of Clothing, FY2004



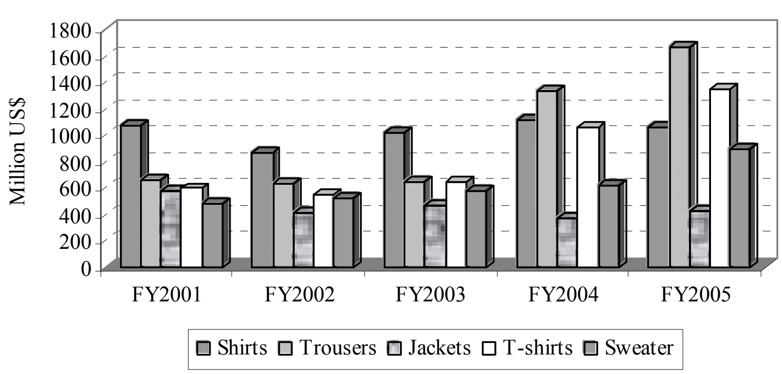
Source: WTO (2005)

[26]See WTO (2006)

However, due to inadequate backward linkages, the RMG sector depends heavily on imports of raw cotton and yarns, which constituted 17.2 per cent of total exports in FY2004.[27] The volume and quantity of domestic output of these raw materials in 2006 was able to meet about 80 per cent and 24 per cent of demand by the export-oriented knitted and woven RMG industries, respectively.[28]

The structure of RMG sector has been changed over time. During the initial period the structure of RMG exports was dominated by woven garments, but in recent years the knitted garment's share is growing up steadily. The share of knitted garments in total RMG exports has increased from 18.1 per cent in 1994 to 40.72 per cent in 2004 while that of woven garments declined from 81.9 per cent to 59.27 per cent during the same period. The product base of RMG sector has been diversified from ordinary shirts, T-shirts, pyjamas, trousers, shorts, caps, women's and children's wear to sophisticated high value shirts, jackets, sweaters, jeans and embroidered wear; and some brand items have also emerged where the value was added to both the export earnings and the local value retention (Figure 5.2).

Figure 5.2: Main Apparel Items Exported from Bangladesh

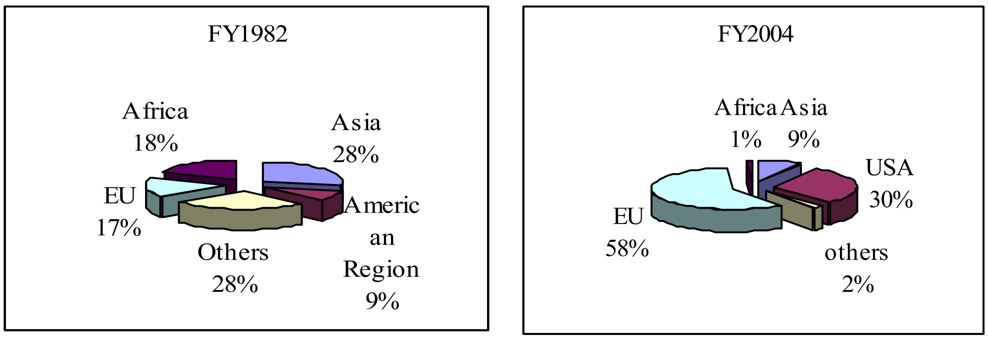


Source: BGMEA, Bangladesh

[27] Ibid
[28] Ibid

The destination of Bangladesh's exports has also been changed over the decades. In FY2004 the total export share in the USA rose to 29.6 per cent from only 9 per cent in FY1982 and in EU export share increased to 58.6 per cent from 17 per cent over the same period. The knitted and woven RMG are the main export item to these destinations.

Figure 5.3: Region-wise Share of Total Exports, FY 1982 and FY2004



Source: EPB, Bangladesh

The most important contributing factor in the rapid expansion of RMG exports in the MFA regime have been the quota-free facility given by the EU under its Generalized System of Preference (GSP) scheme, and the considerable quotas made available in the United States and Canada under bilateral agreements. In addition over the years, to encourage exports particularly in the RMG sector, government introduced generous promotional measures like subsidized rate on interest on bank loans, provision of import under back-to-back letter of credit, duty free import of machinery and intermediate inputs, credit at concessional rate, duty drawbacks, cash subsidy, and exemption from value-added and other taxes. Nonetheless, the RMG sector's competitiveness has been reduced by both structural and policy-induced rigidities which included, inter alia, defective and insufficient infrastructure; widespread corruption; high levels of nonperforming loans; restrictions on FDI in the sector; a requirement to have back-to-back letters of credit (LCs) before imports can be approved; a requirement to reserve 40 per cent of exports cargo for domestic vessels; and an inefficient quota allocation system based on past performance.[29]

5.2.2 Post-MFA Scenario

After the expiry of the MFA regime on 1 January 2005, it was anticipated that the pace of expansion of RMG sector in Bangladesh would reduce significantly; thus country's export would fall substantially and its balance of payments position could be weakened considerably. However, Bangladesh has maintained a moderate growth in RMG exports in 2005 and 2006 – the first two years of the post MFA regime. As table 5.1 shows, in the quota-free regime the export earnings from RMG sector stood at US$ 6.9 billion and US$ 8.93 billion in 2005 and 2006 respectively which were higher than previous years. It indicates that RMG exports grew by 11 per cent in 2005 and 29.46 per cent in 2006. Export data disaggregated between woven and knitted RMG shows that the knitted garments has performed better than the woven in the post MFA regime. During 2005-2006 the knitwear and woven products grew at an annual average rate of 31.72 per cent and 11.62 per cent respectively. Export of knitted garments stood at US$ 4.38 billion in 2006 as against US$ 2.53 billion in 2004, while the woven exports stood at US$ 4.54 billion as against US$ 3.68 billion during the same period.

Table 5.1: RMG Exports from Bangladesh, 2004-2006 (Calendar Year Basis)

Year	*Woven (US$ billion)*	*Knit (US$ billion)*	*Total exports (US$ billion)*	*Growth rate (%)*
2004	3.686	2.532	6.219	18.48
2005	3.689	3.210	6.900	10.94
2006	4.544	4.388	8.933	29.46

Source: BGMEA, Bangladesh

The main destinations for RMG exports remain the USA and the EU in the quota-free regime. Comparing RMG export in the USA market between MFA and post MFA regime, it is

[29] See Mlachila and Yang (2004)

observed that RMG export value increased in the free trade regime from US$ 2066 million in 2004 to 2998 million in 2006. Similarly, export quantity increased from 1108.5 million SMEs[30] to 1495.5 million SMEs over the same period. Bangladesh's market share in the USA also increased in the post MFA regime in terms of both export value and quantity from 2.48 and 2.3 per cent respectively in 2004 to 3.20 and 2.9 per cent respectively in 2006.

Table 5.2: Bangladesh's Exports of RMG in the USA Market (2004-2006)

Year	*Export value (US$ million)*	*Growth rate (%)*	*Market share (%) in terms of value*	*Export quantity (Million SMEs)*	*Growth quantity (%)*	*Market share in terms of quantity (%)*
2004	2066	6.55	2.48	1108.5	- 0.09	2.3
2005	2457	18.92	2.48	1313.7	18.5	2.6
2006	2998	22.02	3.20	1494.5	13.8	2.9

Source: ITCB, USITC (2007)

In the EU, Bangladesh's RMG export value in the first year of the post MFA regime (2005) stood at US$ 4614 million which was lower than the export value of US$ 4843 million in 2004. However, a strong recovery was made in 2006, when export value of RMG rose to US$ 6035 million with 6.1 per cent share of the EU market. RMG exports in terms of quantity also followed the same trend and increased from 564,789 to 653,816 tons over the past two years.

Table 5.3: Bangladesh's Exports of RMG in the EU25 Market (2004-2006)

Year	*Export value (US$ million)*	*Growth rate (%)*	*Market share (%) in terms of value*	*Export quantity (tons)*	*Growth quantity (%)*	*Market share in terms of quantity (%)*
2004	4843	32.1	5.7	564,789	22.0	--
2005	4614	-4.7	--	558,929	-1.0	--
2006	6035	30.8	6.1	653,816	17.0	--

-- Not available
Source: ITCB

The above analysis shows that the adverse impact of the phase out of quota under MFA/ATC on RMG export of Bangladesh has so far been minimal and Bangladesh achieved a moderate export

[30] Square meter equivalents

growth of 20-30 per cent even in the quota free regime during last two years. This achievement may be because of the execution of previous export orders, safeguards imposed by USA and EU on imports from China as well as different government supporting measures to help the industry to tide over difficulties posed by the abolition of quota. Therefore, it is still too early to pass any judgments on the implication of the MFA phase out on Bangladesh's future exports.

5.4 Challenges

5.4.1 Post-MFA Challenges of Bangladesh

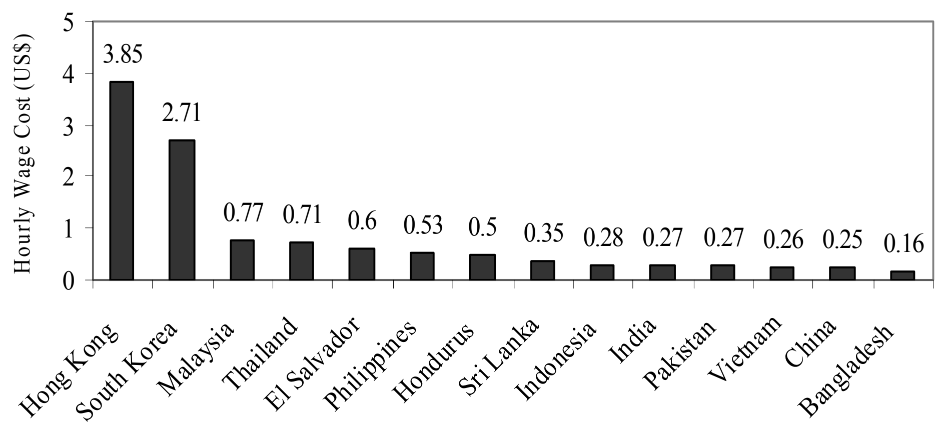
Bangladesh's robust performances to date is attributable to significant competitive advantages emanating from its abundant low-cost labour, the flexible exchange rate, and increasingly close connections with major international buyers that are allowing the industry to benefit from transfer of knowledge and technology.[31] As Figure 5.4 shows, the hourly wage costs are lowest in Bangladesh RMG sector, giving it comparative advantage over most of the Asian manufacturing countries. Thus Bangladesh has been able to maintain its price competitiveness in relation to major competitors like, China, India and Vietnam.

However, Bangladesh might face fierce competition in its largest RMG export markets from 2008 onwards as the safeguard restriction on China expired. China has resource based advantages in cotton, silk, wool, manmade fibers as well as capacity based advantages in the textile spinning and weaving. It is also cost competitive with regard to manufacture of textured yarn, knitted yarn fabric and woven textured fabric. Because of these advantages China's share in the US import market in terms of volume increased by 11 per cent during 2004-06[32] in spite of safeguard restrictions. India has also resource based advantages like China as well as cost competitive with regard to manufacture of ring-yarn, O-E yarn, woven O-E yarn fabric, knitted ring yarn fabric and knitted O-E yarn fabric. Therefore, both China and India

[31] See Mahmud (2007)
[32] USITC (2007)

may emerge as additional market gainer and as great threat for Bangladesh in the quota free regime. Moreover, Vietnam's entry into WTO in January 2007 poses a challenge for Bangladesh since Vietnam now has quota free access to the large markets in which both countries compete head-to-head.[33] Therefore, it will be challenging and difficult task for Bangladesh to continue the momentum in export earnings in its RMG sector in next days to come.

Figure 5.4: Hourly Wage Costs of Selected Countries in the RMG Sector



Source: Absar (2003)

Bangladesh's ability to overcome the challenges of quota-free world depend upon its ability to enhance competitiveness and general business climate which require elimination of existing supply side constraints on a priority basis. The foremost among these is the reduction of lead-time from current 90-120 days to a more ideal lead-time of 30-45 days. However, this would demand greater attention on governance related issue. The port should be more efficient and user friendly, customs procedure and transportation services should be modernized for discharging the raw materials to the factories. The weak backward linkage support of clothing sector also recognized as a major constraint for sustainable export growth of RMG in Bangladesh. After the abolishment of quota regime some of major textile

[33] See, for example, Mahmud (2007)

suppliers, like China, India, Pakistan, Turkey, Egypt and Indonesia, increased their own RMG exports. Therefore, establishment of a strong backward linkage is a most important challenge for Bangladesh in order to produce RMG items competitively at home and enjoy increased market access in the post MFA regime. Another important constraint for competitiveness of RMG exports is the absence of infrastructural facilities which increase time requirement and cost of export. For example, a businessman in Bangladesh needs 35 days to export and incurs US$ 902 per container, whereas his counterpart in Sri Lanka requires 25 days and spends US$ 797 per container.[34] The recent labour unrest in the Bangladesh's garment sector highlights the importance of improve labour laws, safety standard, working conditions and implementation of wage agreements. Amongst other supply side constraints lack of investment fund and working capital, shortage of skilled workers, lack of research and training facilities, invisible cost of doing business, political instability etc. need to be removed to maintain growth of RMG in the post MFA regime.

5.3.2 Post MFA Challenges on Economic Welfare

As the MFA quota phased out at the end of December, 2004, the GTAP model predicted export shocks and economic welfare losses for Bangladesh, albeit with a lag. Over three-to-four years, the model predicted, the economic welfare costs could run to $370 million. In terms of jobs, Bangladesh's losses could be significant- 17 percent of the current work force in apparel and 5 percent in textiles. India and perhaps Pakistan could achieve notable gains in South Asia, but Chinese workers appear to be the major winners as demand for textile and apparel, including those of their linking industries, rises sharply with opening up of global markets. To take advantage of a quota-less trading regime, China, it is feared, could develop the entire range of textile industries from cotton to ready-made garments. The surge in China's import of textile and clothing related machinery appears corroborate these concerns. Between 2000 and 2003, China's import of textile and clothing machinery increased from about $2 billion to more than $5 billion. Some experts are predicting that China may capture as much as 50 percent of the global export market.

[34] See Ahmed and Hossain (2006)

Table 5.4: Export of RMG 2001-05

(US$ million)

	Woven Garments	Knit Garments	RMG Total
2000-2001	3,364.2	1,496.4	4,860.6
2001-2002	3,124.6	1,496.4	4,583.8
2002-2003	3,258.3	1,653.8	4,912.1
2003-2004	3,538.1	2,148.0	5,686.1
2004-2005	3,598.2	2,819.5	6,417.7
Year-on-year growth (%)			
2001-2002	-7.1	-2.5	-5.7
2002-2003	4.3	13.3	7.2
2003-2004	8.6	29.9	15.8
2004-2005	1.7	31.3	12.9

Source: Export Promotion Bureau

Success in the coming contest for trade is vital to Bangladesh's economic growth prospects and its hopes of meeting the MDG goal of halving extreme poverty by 2015. As global RMG competition rises, Bangladesh could not afford to be sidelined. The economy-wide effect of losing ground could be traumatic. Three-quarters of all 2003/04 exports- $5.7 billion of a total $7.6 billion – came from the sales of knitwear and woven goods, and 90 percent of all RMG exports went to buyers in the US and EU. Although the apparel sector contributes 5% to the country's GDP, it is biggest source of industrial jobs. Along with accessories industries it provides direct employment for over two million workers, mostly women. Approximately eight million more Bangladeshis rely indirectly for their livelihood on the RMG industry. RMG not only accounts for 40% of industrial employment, but has also become the main source of foreign exchange earnings needed to finance vital imports of capital goods and essential inputs while serving, as well, as an important training ground for a growing number of new entrepreneurs.

5.3.3 Post MFA Challenges on Employment

As the MFA phase out takes hold and as countries like China-India build ever more formidable RMG export industry, a substantial part of Bangladesh's workforce could be at risk of job loss if the industry fails to stay competitive. The global impact of two measures- abolishing apparel quotas, and instituting safeguards in US and EU against cheaper imports. Global gains from quota abolition, in terms of money-metric measures of economic welfare, aggregates to over $16 billion. The principal beneficiaries would be the US ($6 billion), EU25 (9.4 billion) and China (over $3 billion). Following quota abolition, the reconfiguration of export and import flows between regions and countries results in changes in employment of unskilled labour, which is the principal category of workforce engaged in textile and apparel industry across countries. The implication for employment changes are summarized in Table 3 below showing Bangladesh could suffer significant employment losses- 17 percent in apparel and 5 percent in textile sector though India and perhaps Pakistan achieve notable gains in South Asia. The Chinese workforce appears to be the major winner as demand for textile and apparel, including those of their linkage industries, rises sharply with opening up of global markets.

Table 5.5: Changes in Unskilled Labour after Quota Abolition

Country/Region	Changes in Unskilled Labour (%)		
	Raw Materials for Textile	Textile	Apparel
EU25	2	-17	-19
China	24	26	59
Bangladesh	1	-5	-17
India	3	4	6
Sri Lanka	5	-3	-17
Rest of South Asia	6	13	3
United States	-1	-12	-19

Source: Vlad Manole (2005)

5.4 Gearing Up to Compete: Strategic Policy Options

It is not a foregone conclusion that Bangladesh must fall behind in the race to supply global markets, especially those of the US and EU, with ready-made garments and other textile products. The race, like others, will be to swift, and Bangladesh can take steps now that will accelerate its responsiveness and lighten the load its RMG firms carry in the contest.

In the post-MFA world, lead-time has emerged as a crucial determinant of competitiveness. More that in the past vendors need to show apparel trade buyers that they can fill orders fast. While several developments in the retail business have sharply reduced lead-time in US and Europe, Bangladesh woven RMG manufacturers have continued to lag. Among competing countries, their lead time is one of the longest (90-120 days), principally because of inadequate, easily available suppliers of local oven fabrics and the consequent need to procure the raw materials from overseas. If the raw materials could be sourced locally the time required to receive them at the factory gate could be reduced from 42-60 days to just one or two weeks, putting Bangladesh garments exporters on a par, in terms of lead-time, with their major competitors.

5.4.1 Improving the Domestic and Regional Supply Chain

The challenge is easier to describe than to overcome. The best solution, increasing domestic supplies, is not attainable in a short period, but more easily and rapidly, part of the demand might be met by increasing the capacity of dyeing and finishing industries. If they were allowed to stock up grey fabric in advance of orders, they could supply finished fabric to the woven garments manufacturers at fairly short notice. Since the lead-time would not be greater than when domestic fabric were used, this option merits serious consideration.

It will, however, take at last a few years of building up the dyeing and finishing sub-sector to close or dramatically narrow the demand –supply gap. The gestation time would be long; but since the next few years will be crucial for the health of RMG woven industries of Bangladesh, other innovative tactics need to be explored. One could come from building closer relationship with nearby suppliers (e.g. in South Asia Region) in order to receive fabric at short notice, a course without foreseeable outcomes. Currently, although RMG manufacturers are free to import fabric from these countries, they have sourced only a small fraction of their requirement from nearby country such as India, Thailand and Pakistan. They may need the incentive of special advantages given them in order to increase imports, but domestic textile manufacturers as well as competing countries are very likely to oppose such provisions vigorously.

5.4.2 Opening Land Routes and Modernizing Port and Customs Facilities

Even without new inducement, Bangladesh could markedly improve its utilization of available means to reduce lead-time by sourcing inputs from the region, starting by rescinding the ban on importing yarn from India by land routes. Whatever reluctance there may be to forging closer links with India or Pakistan for supply of inputs at shorter notice has to be weighted against the urgent need to cut lead time by bringing yarn to knitters and weavers as rapidly as possible. The policy now in place needs to be reviewed. Government of Bangladesh has to explore every option and adopt the appropriate one, implication of which, would lead to a congenial atmosphere for free-trade negotiations with India or with other neighbours in South Asia.

The removal of the ban may be one of different elements in a concerted effort to smooth the path of imports- in some cases, smooth is literally by repairing the roads and modernizing the Chittagong port that constitute serious bottlenecks to the flow of goods. It is important to remedy the power and transportation infrastructure failures that exporters see as heavy burdens on their competitive performance. While there is no doubt that additional investment is required in energy and transport infrastructure, the changes that are required most immediately are modifications of policies, processes and management before capital investment.

5.4.3 Central Bonded Warehouse (CBW) Facilities

Because a CBW-system will make imported fabric available as quickly as, in some cases more quickly than, domestic fabric, RMG producers who are procuring domestic fabric may switch to cheaper CBW suppliers. This prospect generates opposition from textile manufacturers who want priority given to lead-time-reduction measures that would increase their production, not make competing imports more attractive. The reality, though, is that Bangladesh's modern textile industry owes its growth to the RMG industry, and faster growth of RMG – a goal dependant on cutting the tie between ordered and delivered goods- the larger will the market be for domestic textile producers. CBW offers a way to cut lead time, enhance competitiveness, and thus to improve performance and profit throughout the textile sector.

5.4.4 Textile Protection Impedes RMG growth: It has also been suggested that the government should actively pursue policies that could quickly increase the capacity of the primary textile sector (PTS) so that they could meet the entire demand for woven garments. To make this possible, the arguments go, existing measures that restrict fabric imports and thus protect the PTS should be maintained. Electing/Selecting such a policy would run counter to the reality that no government can truly judge or accurately forecast the success of a particular business. Governments do not and will not always choose winners. Indeed, they are more likely to bend to lobby pressure. The best policy for a government is accordingly to take an even-handed approach to all industries by removing any constraints to fair market competition. The challenge for Bangladesh is to adopt domestic policies that ensure a smooth supply of raw materials/inputs to the apparel sector at international prices. Restricting supply in order to protect primary processors is unlikely to strengthen such manufacturers and certain to penalize RMG exporters.

5.5 Conclusions

Bangladesh economy at present is more globally integrated and facing much more competition in the international market than at any time in the past. The MFA phase out provides an opportunity to expand trade, generate new employment and achieve higher rate of growth if Bangladesh can improve its competitiveness. However, there is possibility of adverse impact on the commodity trade, if the country fails to diversify its exports, quality of products are not improved, backward linkage industries to garment sector are not established to increase value addition and relevant industrial infrastructures are not developed to increase its competitiveness. In order to improve the competitiveness of RMG sector and avail the opportunities of the quota free world the government and RMG sector should work together.

CHAPTER VI

POLICY SWITCH IN RMG SECTOR- PROSPECTS

6.1 Introduction:

The end of MFA presents both challenges and opportunities for the RMG sector of Bangladesh. There are many uncertainties about new market developments in the coming months. What is certain is that there will be heightened competitive pressure with the more efficient producers attempting to capture a large share of the global market. Signs of this are already visible. To sustain and enhance Bangladesh's share, all stakeholders including the government, industry and individual firms will have to quickly respond to the emerging situation with the right policies and actions in order to become more competitive. As stated at the outset, the cost of inaction or policy errors could be severe. Delay to adopt the right policies, or remove the constraints, can only raise the cost of missed opportunities and reduce the competitive strength of the sector that that has made a remarkable contribution to industrial employment, women empowerment and reduction of poverty. It would be unfortunate if the growth potential of the sector is stifled or the hard earned gains whittled away because of policy failures. More important, it would be grave mistake to take any policy and/or institutional action that might undermine the RMG sector's export competitiveness, and any existing trade policy distortion that is harming this sector's competitiveness would need to be removed urgently.

6.2 Enhancing Competitiveness

Export concentration in readymade garments makes the economy, jobs and income, extremely vulnerable to external shocks arising from changes in global demand for RMG. Export diversification, therefore, is a high priority**.** But the import regime for other exports is cumbersome and the duty drawback system dysfunctional, thus literally stopping any prospect of export diversification dead on its track. It must be noted that streamlining the import regime for exports in a protected economy such as Bangladesh is just as important for ensuring export competitiveness as reducing anti-export bias of the tariff and QR regime. The broad aim of policy measures to improve Bangladesh's competitive performance is to expand exports and to strengthen growth prospects by raising factor productivity and encouraging private investment. Total Factor Productivity (TFP), i.e., the efficiency with which resources are used in production, has been crucial at the margin to the country's overall economic growth for nearly three decades. Clearly, it is important to improve human capital and to mobilize more investment from foreign and domestic sources. What is also critical for export-accelerated growth, however, is the efficiency with which labor and capital resources do their work. Inefficiencies of various kinds and degrees of severity now hamper all sorts of enterprises.

6.3 Reduce the Remaining Significant anti-Export Bias

Although Bangladesh has managed to insulate the RMG sector through the bonded-warehouse and EPZ schemes from the effect of protectionist policies, further trade reforms are needed to provide comparable stimulus to other industries with the potential of diversifying the country's exports [World Bank 2005a]. In addition to dealing with the flaws in governance, transport and finance trade related policy changes need to further simplify the import tax regime and reduce the dispersion and average level of nominal (and thus effective) protection, preferably through a pre-announced medium and long term schedule of tariff reduction, and the elimination of any remaining protective quantitative restrictions. At the same time, Bangladesh should avoid using direct export subsidies because of the strong likelihood of their abuse and limited impact. Policy reform should focus instead of addressing the costly bottlenecks that damage not only performance but also the investment climate. Specifically, to bring high payoffs in export competitiveness, reform should be a priority in Customs as well as the Duty Exemption and Drawback Office (DEDO). Practices in both these services are characterized by inefficiency and rent-seeking that penalizes firm capable, in a freer regulatory environment, of expanding Bangladesh's share of world trade.

6.4 Infrastructure Development

A through going program is required to match infrastructure services to the need of a growing, outward-looking economy. The basic goal should be to redefine the role of the public sector from service provision to regulation while encouraging private-sector participation by establishing rules of competition, strengthening the regulatory environment, and addressing the problem of poorly performing state-owned enterprises (SOEs). Specifically, it is important to remedy the power and transportation infrastructure failure that exporters see as heavy burdens on their competitive performance. While there is no doubt that additional investment is required in energy and transport infrastructure, the World Bank (2005a) report concluded that the changes that are required most immediately are modifications of policies, processes and management rather than capital investment.

6.5 Reducing Lead Time

In the post-MFA world, lead-time has emerged as a crucial determinant of competitiveness or attractiveness of the vendor to the buyer in the apparel trade. Several new developments in the retail business have contributed to a sharp decline in the lead-time in USA and Europe. Bangladesh woven RMG manufacturers have one of the longest lead times amongst competing countries. The principal reason for the long lead-time is the unavailability of local woven fabric.

Time factors can be an important trade barrier for intermediary inputs involved in an internationally fragmented production process. There are trade-offs between low wage cost and time factors since temporal proximity to large consumer market provides a competitive edge in the highly competitive, time sensitive, and fashion-oriented clothing market. Thus OECD warns that counties that rely on imported intermediate inputs (such as fabric) and have a long lead-time will face some competitive disadvantage in the post-MFA world. Lead-time was also mentioned by leading buyers of apparel as one of their two main concerns in a discussion meeting with the stakeholders in Dhaka recently.

Table 6.1: Lead time for Servicing an Order for RMG

	Lead time (days)
Cambodia	90-120
China	45-60
Indonesia	60-90
Malaysia	60-90
Thailand	60-90
Vietnam	60-90
Bangladesh	90-120

Source: BGMEA (2004a)

It is evident that much of the excess time required for processing an order is due to having to procure the raw materials from overseas. If the raw materials could be sourced locally the time required to receive them at the factory gate could be reduced from 42-60 days to just one or two weeks. Hence, local sourcing could reduce the lead-time to 55-75 days. This would make the lead-time of Bangladeshi garment exporters comparable to that its major competitors.

Table 6.2: Typical Lead Time Components for Bangladesh (Days)

Days taken after ceding step		
	Optimal	Non-optimal
Exporter receive confirmed LC	0	0
Raw material supplier receives LC	4	6
Raw material supplier produces and ships goods	7	15
Ship berths at port of import	26	30
Raw material is unloaded and taken delivery from port	4	7
Consignment reaches factory	1	2
Garment packed and shipped	20	30
Consignment reaches buyer's port	28	30
Total	**90**	**120**

Source: BGMEA (2004a)

There is little prospect of changing the situation in the short to medium term given the very large investment requirement and an adverse international market situation characterized by over-capacity and low prices. Hence, some innovative scheme needs to be put in place to shorten the lead-time. One such scheme is the establishment of central bonded warehouses (CBW). CBW can reduce the lead-time of local manufacturers to the level of competing countries. However, to reap the full benefits of CBW, these would have to be complemented by good processing facilities. Appropriate policies to set up CBW with adequate safeguards against leakages, such as that suggested by the National Coordination Council, should be implemented to ensure that the local woven RMG manufacturers do not lose out to competitors because of the long lead time.

6.6 Capacity Enhancement of the Primary Textile sector (PTS)

There is a suggestion that the government should actively pursue policies to quickly increase the capacity of the woven PTS, such that they can meet the entire demand for woven garments. To make this possible, the argument goes that the protective measures for the PTS should be maintained. Some caution is needed in restoring to such a course. The government in any country is not in the best position to judge or accurately forecast the success of a particular business and hence, it will not always correctly choose winners. It is most likely to bend to lobby pressure. The best course for policy action for a government is accordingly to take an even-handed approach to all industries by removing any constraints to fair market competition. There were several studies done in most South Asian countries in order to formulate a strategic vision for the apparel-textile sectors under the post-MFA regime. In these studies, the potential for the apparel sector to lead the thrust for textile growth has been recognized. So is the case in Bangladesh. This brings up the strategic importance of domestic policies to ensure a smooth supply of raw materials/inputs to the apparel sector at international prices.

6.7 Public-Private Partnership

Bangladesh must forge a concerted public-private partnership to correct the weakness that interfere most with their competitive strengths that partnership needs, among other challenges, to address serious shortcomings with regard to the country's international market orientation – the ability to gear up its marketing campaign in response to changing demand. Long years of exclusive reliance on foreign buying houses or their agents have left ingrained habits that are out of step with the post-MFA demands for savvy merchandising and marketing of products in order to penetrate and maintain market share in export markets. A partnership between government and the RMG sector must focus on such forward linkage. The following approaches highlight some of the key strategies for promoting forward market integration:

6.8 Product and Market Diversification

One of the major limitations to apparel export growth is the lack of diversification in products and markets. A small range of products (shirts, trousers, T-shirts, sweaters, jackets) makes up to 60 percent of RMG exports. Vigorous marketing and promotional drives would be needed to break into markets for other RMG products that Bangladesh producers can produce competitively. Since R&D and market research to expand the product mix and public support in this area will be critical, a comprehensive research centre built on public-private partnership should be established. Its role would be to gather and disseminate information effectively to local manufacturers on the latest developments in products and markets, including information on fabric developments, blends, colours, patterns, latest fashion trends and design forecasting, as well as providing customer service to foreign buyers purchasing from Bangladesh.

6.9 Image Building and Brand Development

Image building and branding can achieve a high level of value addition and enhance Bangladesh's reputation as a quality supplier of apparel. As branding is an expensive investment, incentives and opportunities should be provided to exporters, such as through a 'Brand Fund' and by encouraging foreign collaboration to launch collective brand names through corporate marketing companies. Investments in skills, design and advertising will be essential for the "Made in Bangladesh" label to make its mark in the global marketplace. For this, an active promotion campaign will be required by the industry, government and export promotion Bureau. Local and international exhibitions should be held with aggressive efforts to attract foreign buyers. Bangladesh embassies abroad should appoint dynamic business-oriented commercial officers whose main job will be to promote export products through direct contact with potential buyers.

6.10 Performance Rating Database

At home an exporter's performance rating database could also be developed, based on factors such as product quality, timely delivery and financial performance. This facility should be set up in collaboration with an accredited international company so as to ensure objectivity and credibility.

6.11 FDI or Joint Ventures

Bangladesh has been a reluctant recipient of FDI, at least in the RMG sector, limiting it, until recently, to EPZ only while the domestic sector was kept off limits for foreign equity or partnership. Less than 15 percent of Bangladesh garment firms have foreign equity. This policy has had one positive impact – growth of indigenous entrepreneurs who are now much more prepared to face the post-MFA challenges on their own. Although the restrictions on FDI were finally removed in the Industrial Policy 2005, the Bangladesh RMG sector may have missed out on certain benefits that accrue from the presence of FDI in the sector. A survey of RMG firms showed those with foreign equity to have productivity levels on average 20 percent higher than those without. In addition, the survey showed positive and significant productivity spillovers. For every 10 percent increase in the productivity level of FDI in the industry, productivity of domestic firms increases by 1.4 percent. Although Bangladesh has a limited number of joint venture RMG industries, even these can be very effective in bringing in managerial and marketing expertise. Continuous efforts should be made by the Export Promotion Bureau and Board of Investment to ensure that the invest climate of the future favours more FDI or joint ventures. The positive spillover effects of FDI can make a substantial addition to Bangladesh's existing strengths.

6.12 Conclusion

The end of MFA presents both challenges and opportunities for the RMG sector of Bangladesh There are many uncertainties about new market developments in the coming months. What is certain is that there will be heightened competitive pressure with the more efficient producers attempting to capture a larger share of the global market. To sustain and enhance Bangladesh's share, all stakeholders including the government, industry and individual firms will have to get behind policies and actions that help Bangladesh become more competitive.

Delay in adopting the right policies or removing harmful constraints can only raise the cost of missed opportunities and reduce the competitive strength of the sector that has made a remarkable contribution to industrial employment, women empowerment, and reduction of poverty. Above all, it would be a grave mistake to take any policy and/or institutional action that might undermine the RMG sector's export competitiveness, and any existing trade policy distortion that is harming this sector's competitiveness would need to be removed urgently.

The stakes are high and the competition is mounting. Bangladesh has a strong position from which to compete and a wide choice of promising policies to pursue. The one unacceptable policy choice is inaction.

Table 6.3: Key Strategic Options and Recommendations

Key strategic options	Recommendations
1. Raising productivity is key to competitiveness	Now that the FDI restrictions has been removed from the industrial policy 2005, all efforts should be made to facilitate FDI inflows into the sector to take advantage of better management, technology, capital and market access.
2. Reducing lead time is critical	Overhaul Chittagong port facilities, improve infrastructure and transport logistics and streamline the import regime by removing cumbersome procedures. End the ban on yarn imports through land ports. The government has since removed the ban on yarn imports over the land routes for 100% of export oriented industries.
3. RMG sector must not be held hostage to backward linkage.	If the Government desires to provide support to the textile industry, such as interest rate or price support, it must do so through its normal budgetary instruments in a transparent manner. The cost of support must not be shifted to the RMG industry that is totally unprotected in the international market.
4. Central Bonded Warehouse for quickening delivery time.	Permit the establishment of CBW in line with the recommendation of the National Coordination Council.
5. Make the most of preferential market access which gives price advantage.	Bangladesh should seize the opportunities offered to it as an LDC but use the space to prepare for increased competition when it graduates out of the LDC league.
6. Take advantage of Regional Cumulation.	Government should lobby hard with EU to reduce value added requirement along with liberal regional cumulation option.
7. Compliance with social and labor standard.	To remain competitive and win orders, RMG firms must conform to international standards of social compliance for their industry.

CHAPTER VII

TRADE OPENNESS
AND
EMPIRICAL ANALYSIS OF THE RMG EXPORT TRENDS IN PRE AND POST MFA PERIODS

7.1 Introduction

There is a relationship between the openness of the economy i.e. trade liberalization and enhanced trade i.e. economic growth of a country. As Bangladesh started the economy to liberalize extensively since the beginning of 1990s the economy has been growing faster through increased earnings from trade. It is evident that a major part of its total export earning consists of the earnings from the exports of Readymade Garments (RMG). Hence, in the context of the economy of Bangladesh, trade liberalization and economic growth through enhanced RMG export earning has become an important issue. Specifically, in the event of MFA phase out it has now become an important issue to examine whether the economy of Bangladesh performing at the desired pace so that it could maintain the earlier trend of economic growth. Has trade liberalization any impact on economic growth despite MFA phase out? A large number of empirical studies have been undertaken to analyze the impact of trade liberalization on export growth i.e. on economic growth in developing countries like Bangladesh using a range of econometric methodologies with cross-sectional, panel and time series data, but findings of these studies are inconclusive. This chapter empirically examines the effect of trade liberalization on economic growth through enhanced export earning using time series data from Bangladesh. It is hypothesized that trade liberalization led to higher economic growth and in order to verify this hypothesis the annual data for a period of 35 years (1974–2008) analyze using the cointegration approach. A set of time series variables is said to be cointegrated if they are integrated of the same order and a linear combination of them is stationary which points to the existence of a long term relationship among the variables.[35] The advantage of cointegration analysis is that through building an error correction model (ECM), the dynamic co-movement among variables and the adjustment process toward long-term equilibrium can be examined.[36]

7.2 Empirical Model Specification and Methodology

In order to examine the relationship between trade liberalization and economic growth through enhanced export earnings, the empirical model is derived from an aggregate production function framework. Following Lucas (1988) the aggregate production function for economic growth of Bangladesh is specified in the following way:

$$Y = f(K, L, H, TL) \tag{1}$$

Where Y is output, K is physical capital, L is labour force, H is human capital and TL is trade liberalization indicator. In this paper, trade liberalization indicator, TL, is measured by trade ratios, exports plus imports as percentage of real gross domestic product (GDP). Physical capital, K, is proxied by gross domestic fixed capital formation due to the lack of a reliable data series on capital stock for Bangladesh.[37] Human capital, H, is proxied by education expenditure as a ratio of gross national income (GNI). This proxy variable has been used in several empirical studies (e.g., Sylvester, 2000; Kohpaiboon, 2003). H is dropped from the estimation since it's not related with the purpose of our empirical study. Since Bangladesh is a labour abundant country, labour does not act as a constraint to the output in the economy of Bangladesh as a whole.[38] Thus following Salvatore and Hatcher (1992), labour force, L, is dropped as a source of output growth. Furthermore, following Alkinlo (2004) government expenditure on consumption is included in the growth model. Output Y is defined by real GDP. Therefore the estimating equation used in the empirical analysis, is

[35] See Maysami and Koh (2000).
[36] Ibid
[37] This proxy has been used in many other studies, for example, Ahmed (2003), Barro (1999), Levine and Renelt (1992).
[38] See, for example, Ahmed (2003).

$$LRMGExp_t=\alpha_0+ \alpha_1 LGDP_t+\alpha_2 LTLExp_t+\alpha_3 TL_t+\alpha_4 Captial_t+ \alpha_5 LGC_t+ \mu_t \tag{2}$$

Where,

LRMGExp= RMG Export Earning in log form

LGDP = real gross domestic product in log form

LTLExp = real total export earning in log form

CAPITAL = gross domestic fixed capital formation as percentage of GDP

TL = trade openness (exports plus imports as percentage of GDP)

t = time subscript

μ = stochastic error term

It is expected that $\alpha_1>0$, $\alpha_2>0$, $\alpha_3>0$, $\alpha_4>0$ and $\alpha_5>0$

If the time series variables of LRMGExp, LGDP, LTLExp, TL, CAPITAL, and LGC have unit roots, then in order to obtain a stationary series, we need to take the first difference of the variables as follows:

$$\Delta LRMGExp_t=\alpha_0+ \alpha_1 \Delta LGDP_t+\alpha_2\Delta LTLExp_t+\alpha_3\Delta TL_t+\alpha_4\Delta Captial_t+ \alpha_5\Delta LGC_t+ \mu_t \tag{3}$$

Equation (3) ignores the long-run aspects of decision-making, that is, the above procedure of differencing results in a loss of valuable "long-run information" in the data.[39] The cointegration theory addresses this issue by introducing an error correction term (EC) which lagged one period and integrates short-term dynamics in the long-run growth function. This leads to the specification of a general error correction model (ECM):

$$\Delta LRMGExp_t = \beta_0 + \sum_{i=1}^{n}\beta_{1i}\Delta LGDP_{t-i} + \sum_{i=0}^{n}\beta_{2i}\Delta LTLExp_{t-i} + \sum_{i=0}^{n}\beta_{3i}\Delta TL_{t-i} + \sum_{i=0}^{n}\beta_{4i}\Delta Capital_{t-i} + \sum_{i=0}^{n}\beta_{5i}\Delta LGC_{t-i} + \beta_{6i}EC_{t-1} + \varepsilon_t \tag{3}$$

Where EC_{t-1}= error-correction term lagged one period.

The modeling strategy adopted in this study follows a three-step procedure:

[39] See, for example, Ahmed (2003).

(i) determining the order of integration of the variables by using Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) unit-root test;

(ii) if the variables are found to be integrated of same order, cointegration is tested by applying the Johansen (1990) maximum likelihood method; and

(iii) if the variables are found to be cointegrated, ECM is estimated using standard methods and diagnostic tests.

Throughout the whole estimation process a 5% level of significance is applied and the latest available computer software package (Stata) is used for analyzing the data.

7.3 Data Sources

The model is estimated using annual data for the period 1974-2008. Five variables are investigated in the model. The descriptions of the variables are given in Table 6.3 below. Data on RMG Export Earnings, Total Export Earnings, GDP, gross domestic fixed capital formation as percentage of GDP, trade openness are obtained from Bangladesh Bank Statistical Department, Export Promotion Bureau (EPB), Bangladesh Garments Manufacture Exporters Association (BGMEA) Research Division, Bangladesh Bureau of Statistics (BBS), Board of Investment (BOI), *World Development Indicators*, World Bank. All economic figures are measured in millions of US Dollar. The data involved in the regression process are listed in **Table A3** in **Appendix III.**

TABLE 7.1: Variable Description

Variable	***Description***
LRMGExp	Real Total export earning of the RMG sector in Log form
LTLExp	Real Total Export Earning in Log form.
GDP	GDP at purchaser's prices is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources.
CAPITAL	Gross fixed capital formation (formerly gross domestic fixed investment) includes land improvements (fences, ditches, drains, and so on); plant, machinery, and equipment purchases; and the construction of roads, railways, and the like, including schools, offices, hospitals, private residential dwellings, and commercial and industrial buildings.
TL	Trade openness is the sum of exports and imports of goods and services measured as a share of gross domestic product.
LGCE	Real Government consumption expenditure includes all government current expenditures for purchases of goods and services (including compensation of employees). However, some expenditure e.g., expenditure defense and military purposes are excluded.

Source: World Bank, Export Promotion Bureau, Bangladesh Bureau of Statistics.

7.4 Empirical Analysis

7.4.1 Summary Statistics and Trends of Variables

The summary statistics of LRMGExp, LTLExp LGDP, CAPITAL, TL and LGC for the 1974-2008 are given in Table 8.2 as their mean, standard deviation, coefficient of variation, minimum and maximum values.

Table 7.2: Summary Statistics

Variable(s)	*Mean*	*Standard Deviation*	*Coefficient of Variation*	*Minimum*	*Maximum*
LRMGExp	2.282629	.3074433	2.282629	-2	4.0748
LTLExp	3.290722	.0834281	3.290722	2.57026	4.14955
LGDP	4.438338	.0419475	4.438338	3.90671	4.83608
CAPITAL	19.17999	.5813788	19.17999	14.12564	25.76484
TL	25.20449	1.43881	25.20449	14.3675	41.0478
LGCE	10.6081	.2270501	10.6081	7.900834	12.99479

Figures 8.1-8.6 show trends of the main variables over the period. A clear upward trend in GDP, total export earnings, total RMG export earnings, trade openness, and gross fixed capital formation as share of GDP and government expenditure on consumption in Bangladesh in the post-liberalization period (1974-2008) is visible from these figures.

Figure 7.1: GDP Expressed in Log Form

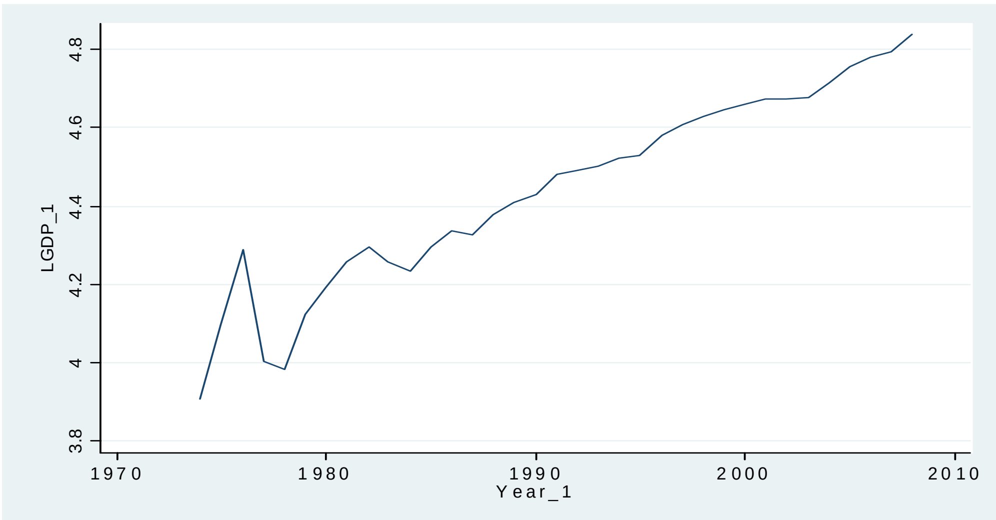


Figure 7.2: Total Export Earning Expressed in Log Form

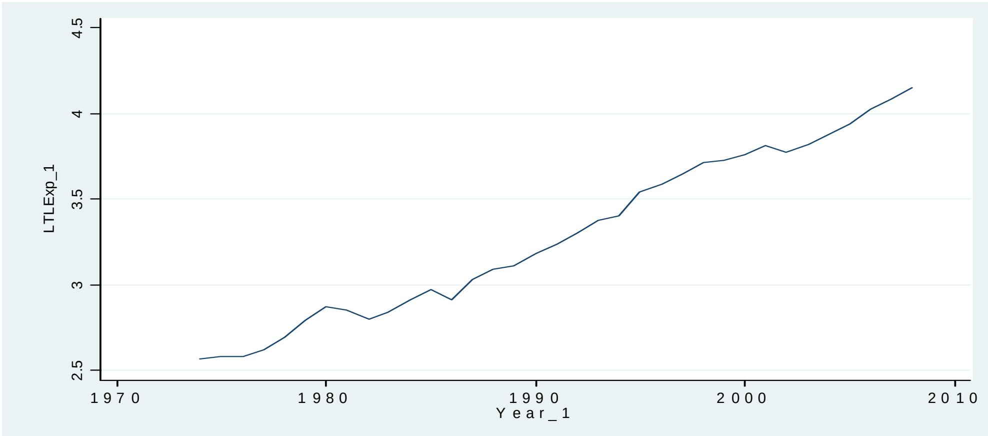


Figure 7.3: Total RMG Export Earning Expressed in Log Form

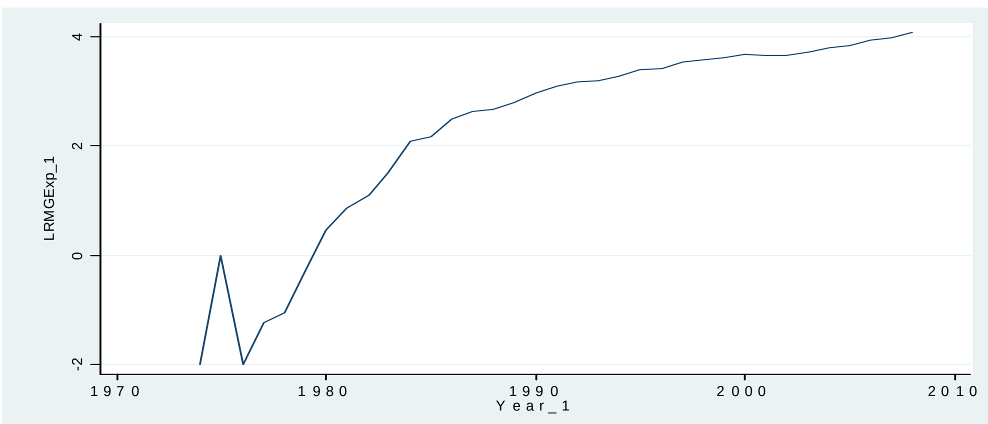


Figure 7.4: Trade Openness (Trade-GDP Ratio)

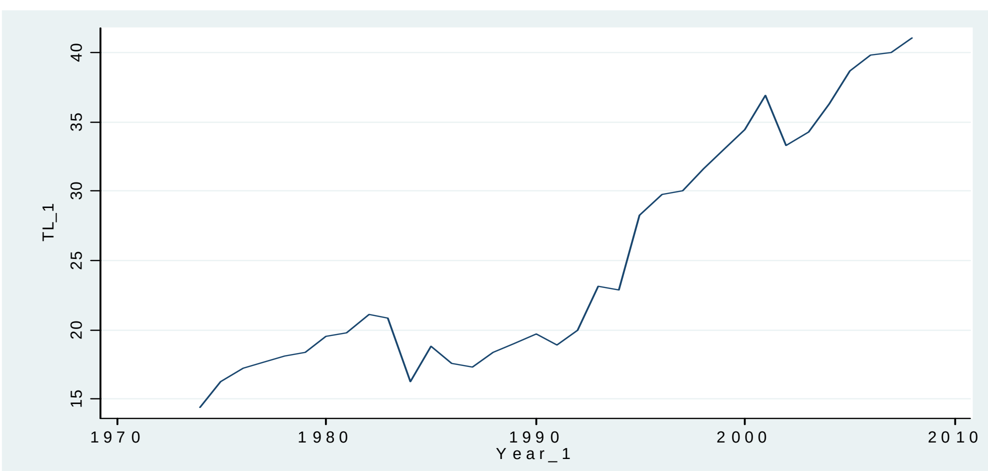


Figure 7.5: Gross Fixed Capital Formation (% of GDP)

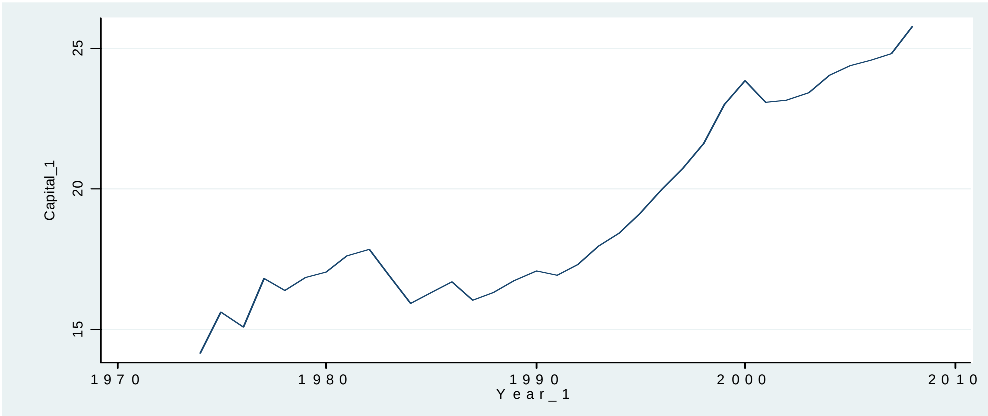
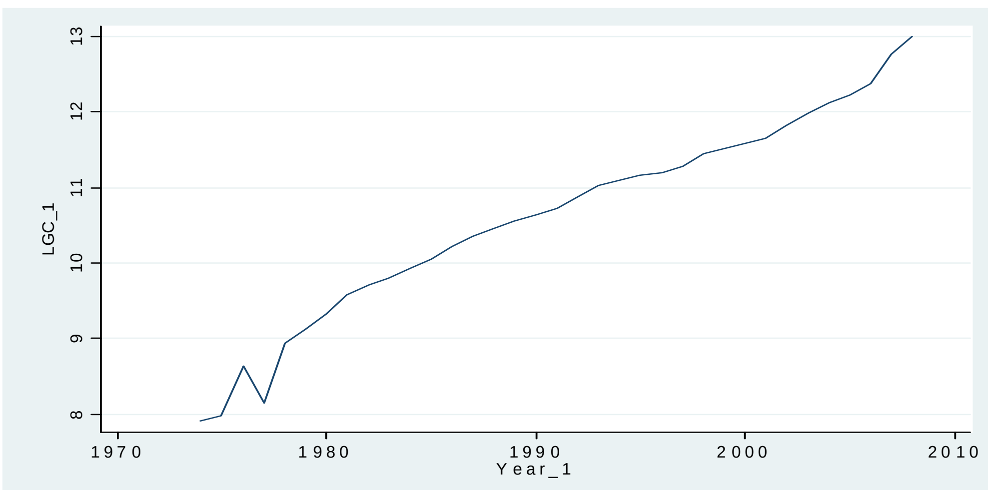


Figure 7.6: Government Consumption in Log Form



7.5 Unit-Root Tests

In order to analyze time-series properties of the data, unit root tests for stationarity are conducted on both levels and first differences of all five variables. Augmented Dicker Fuller (ADF) test and Phillips-Perron (PP) test on all variables are undertaken so as to test the null hypothesis which a series includes a unit root (i.e., it is non-stationary) against the alternative hypothesis (i.e., it is stationary). The results of the ADF and PP tests are shown in Table 8.3.

Table 7.3: Unit Root Tests for Stationarity

Variables	*Level/First Difference*	*ADF Test Statistic*		*PP Test Statistic*		*Conclusion*
		Without Trend	*With Trend*	*Without Trend*	*With Trend*	
LRMGExp	Level	-1.3494(0)	-1.5152(0)	-.349408(0)	-.51517(0)	
	First Difference	-.38518(1)	-.89218(1)	-.34941(1)	-.51517(1)	I(1)
	Second Difference	-.21558(2)	-.71763(2)	-.34941(2)	-.51517(2)	
LTLExp	Level	-.44104(0)	-.99535(0)	.558964(0)	.00465(0)	I(1)
	First Difference	-.32665(1)	-1.1953(1)	.55896(1)	.00465(1)	
	Second Difference	-.20039(2)	-1.2429(2)	.55896(2)	.00465(2)	
LGDP	Level	-.9423 (0)	-1.041972	.05775(0)	-.04197(0)	I(1)
	First Difference	-1.5103(1)	-1.7950(1)	.05775(1)	-.04197(1)	
	Second Difference	-.54427(2)	-1.259(2)	.05775(2)	-.04197(2)	
TL	Level	-.95492(0)	-1.17231(0)	.045080(0)	-.17231(0)	I(1)
	First Difference	-.80645(1)	-1.261(1)	.04508(1)	-.17231(1)	
	Second Difference	-.59692(2)	-1.1711(2)	.04508(2)	-.17231(2)	
CAPITAL	Level	-.81334(0)	-1.0348(0)	.186657(0)	-.03482(0)	
	First Difference	-.49938(1)	-.83146(1)	.18666(1)	-.03482(1)	I(1)
	Second Difference	-.54577(2)	-.98866(2)	.18666(2)	-.03482(1)	
LGC	Level	-.96227(0)	-1.5674(0)	.037731(0)	-.56740(0)	
	First Difference	-.4304 (1)	-1.5014(1)	.03773(1)	-.56740(1)	I(1)
	Second Difference	.00559(2)	-.55349(2)	.03773(2)	-.56740(1)	

The results show the existence of unit roots in all variables and therefore these variables are non- stationary in the zero level, that is, the null hypothesis of a unit root present cannot be rejected. However, the first differences of three variables (LRMGExp, LTLExp and TL) and second differences of two variables (LGDP and CAPITAL) are stationary, while LGC is non-stationary both in first and second differences under the ADF test. On the other hand, the first difference of LGC is stationary under the PP test. This test confirms stationarity for LRMGExp, LTLExp, LGDP, CAPITAL, and TL in similar level and differencing stages as ADF test. Therefore, it can be concluded that the order of integration of the variables is one, I (1).

7.6 Cointegration Tests

Having found that all the six variables are integrated of order one, Johansen Maximum Likelihood procedure is applied to test whether any combination of the variables are cointegrated. This approach presents a unified framework for estimation and testing of cointegrating relations in the context of vector autoregressive (VAR) error correction models.[40] Before undertaking the cointegration tests by using JJML approach, one needs to specify the order of the VAR model. Since the sample size is relatively small in this study, following Pesaran and Pesaran (1997) 2 is selected for the order of the VAR. The results obtained from the JJML approach are presented in Table.

Two tests are used in the JJML approach to determine the number of cointegrating vectors (denoted by r): the maximum eigenvalue test and the trace test. It can be seen that the trace test indicates two cointegrating relationship while the maximum eigenvalue test indicates one cointegrating relationship among the six I(1) variables at 5 per cent significance level. This is also the case at 10% significance level. Since the maximum eigenvalue test is "usually preferred for trying to pin down the number of cointegrating vectors"[41] and it reveals overall the least size distortions over the trace test[42], it can be concluded that there exists only one cointegrating relationship among the six variables in the growth model. Therefore, the annual data from 1974 to 2008 seem to prove the proposition that in Bangladesh there exist a long-run relationship between RMG export earnings and its major determinants of total exports, GDP, gross fixed capital formation as percentage of GDP, trade openness and government expenditure on consumption. The long-run equilibrium relationship can be obtained from single normalized cointegrating vector as follows:

[40] See Pesaran and Pesaran (1997).
[41] See Enders (2004, p. 354).
[42] See Haug (1996).

$$LRMGExp = -.3714323\ LTLExp\ -.1633132\ LGDP + .0003336\ TL + .0196132\ CAPITAL$$
$$(.1252854) \qquad (0.0079735) \qquad (.0046693) \qquad (.0090518)$$

$$-.0709339\ LGC \qquad (5)$$
$$(.04655)$$[43]

7.7 Estimation of Error Correction Model

The ECM from the equilibrium model is estimated to determine the short-run dynamic behaviour of economic growth. The model shows that the coefficient of error correction term is statistically significant at any level with appropriate sign. This suggests a moderate speed of convergence to equilibrium, with some discrepancy corrected for each year. The diagnostic test statistics indicate presence of no mis-specification , no serial correlation, nor any problem of heteroscedasticity and no problem of non-normality in the residuals. The diagnostic test also reflects that the correct forms of parameters are adopted in the model and thus the dependent variable is related to the independent variables and the error term as a linear function. However, none of the explanatory variables are found to be effective in the short-run.

[43] Figures in parentheses indicate standard errors.

CHAPTER VIII

TRADE WITH INDIA- TREND ANALYSIS, PROBLEMS AND PROSPECTS

8.1 Introduction:

Bangladesh and India have long shared the common objective of fostering close economic integration within the South Asia region. While bilateral trade between the two countries has been growing steadily since the early 1990s, exports from India far outweighed imports from Bangladesh, resulting in a yawning trade gap. Only recently, this trend is showing signs of abating with a strong pick up in the exports of Bangladesh, due to tariff concession from India and removal of other trade barriers with mutual agreement. The signing and ratification of South Asia Free Trade Agreement (SAFTA) in early 2006 by the SAARC member countries sets forth the possibility of further consolidation of trading arrangement through the formation of bilateral Free Trade Agreement (FTA).

The trading relationship between India and Bangladesh is currently of special interest in both countries for a number of reasons. Firstly, there are urgent and longstanding concerns in Bangladesh arising from the perennial, large bilateral trade deficit with India, and from the large volumes of informal imports from India across the land border which avoid Bangladesh's import duties. These concerns have been particularly acute on the Bangladesh side in the context of discussions between the two governments of the possibility of a bilateral free trade agreement along the lines of the India-Sri Lanka FTA. Secondly, even though (because of the disparity in the size of the two economies) India's trading relationship with Bangladesh is much less significant for it than it is for Bangladesh, closer economic integration with Bangladesh is nevertheless seen as a very important way of reducing the economic and political isolation of the seven Indian eastern and north eastern states from the rest of the country. Finally, both countries have long shared common objectives for closer economic integration within the South Asian region, and these have recently been reemphasized by signing on to SAFTA, which takes effect from January 2006. Under SAFTA, the preferential tariffs agreed in the various rounds of SAPTA- so far largely ineffective in generating much intra-regional trade-will continue, but a number of ambitious new objectives have been enunciated. These include the eventual elimination of tariffs and non-tariff barriers on trade between the members, the harmonization of customs procedures and documentation, the facilitation of banking relationships, and cooperation and improvements in the infrastructure for regional trade and cross-order investments[44].

8.2 Bangladesh-India Bilateral Trade and Exchange Rates

In 2004 India's officially recorded exports to Bangladesh were about $1.7 billion but its imports from Bangladesh were just $78 million. Since 1996/97 Indian exports to Bangladesh (in nominal US dollars) have been growing at 9.1% annually, just slightly above the general rate of growth of its total merchandise exports (8.4%), but India's imports from Bangladesh over the same period have grown on an average at only 3% annually, compared to average growth of its total imports of 9.2%. Consequently, Bangladesh's bilateral trade deficit with India has been increasing rapidly, on an average at 9.5% annually. However, the bilateral trade deficit narrowed for the first time in fiscal year 2005-06, when Bangladesh's exports rose to $242 million from $144 million in the previous year, while India's exports fell to $1.8 billion from $2 billion in FY 2004-05.

For India, trade with Bangladesh is a very small part of its total trade-just over one percent since the mid-1990s, and currently about 3 percent of its total exports and a miniscule share (0.01%) of its total imports. For Bangladesh, however, India has now become the largest single source of its imports (about 15% of total, ahead of China and Singapore) and accounts for about a tenth of its total trade, despite exports to India which have declined to only slightly above 1% of total exports.

Most Bangladesh imports from India come via the land border. According to incomplete Bangladesh data, during the 1990s about three quarters of imports were by land and river, but the proportion has declined since then to between 50 and 60 percent. Two reasons for the decline in the share of the land border trade are:

- A requirement imposed by Bangladesh in July 2002 and two major imports from India-sugar and textile yarns-henceforth could only be imported by sea. The reason given for these measures was the control of illegal activities and smuggling at or near the land border customs posts[45].

[44] Under the Trade Liberalization Programme of SAFTA, India pares down its tariffs to 0-5% by 2013while Bangladesh has until 2016 to do the same, subject to exclusion of sensitive lists (India's 763 tariff lines versus Bangladesh's 1254, at the 6-digit level).
[45] The ban on sugar imports over land border was lifted in mid-2005 while the ban on yarn imports were removed in December 2005 for 100% export industries.

- Increasing congestions and delays at the land border crossings-especially at Petrapole-Benapole as a result of inadequate infrastructure and administrative capacity on both the Indian and Bangladesh sides.

Studies of informal trade between India and Bangladesh have consistently found a pattern similar to that of formal trade i.e. large volumes of goods being smuggled from India to Bangladesh, but much smaller volumes being smuggled in the other direction. This general conclusion that there is also a substantial trade surplus on informal account, is confirmed once again in the studies done as part of this project. The study finds that apart from cross border smuggling, the practice of over-invoicing and under-invoicing in formal trade makes a significant contribution to the volume of informal trade.

The appreciation of the real Taka/Rupee exchange rate by about 50% between mid-80s up to about 1999, would have contributed to the expansion of both formal and informal Indian exports to Bangladesh, and retarded the growth of Bangladesh exports to India. However, recorded Bangladesh imports from India have grown even more rapidly since the exchange rate trend was reversed after 1999, and Bangladesh exports to India have continued to stagnate. Two possibilities arise: (a) faster productivity growth in India increased the difficulty of Bangladesh exports competing there, offsetting the favourable trend in the in the exchange rate since 1999; (b) significant tariff and non-tariff barriers constraining Bangladesh's major exports i.e. RMG or minor exports which have experienced rapid growth elsewhere.

A nation's overall trade deficit, rather than a bilateral trade deficit, is what matters. Bangladesh's trade deficit with India has been consistently offset by trade surpluses with other countries, especially with the USA and EU, and by workers remittances. These surpluses have in turn supported the exchange rate of the Taka with other currencies, including the Taka/Rupee rate, and have both enabled, and have been consequences of, macroeconomic policies which have avoided destabilizing fluctuations in the balance of payments, domestic prices and the exchange rate. As in other countries, there is no economic logic in the idea that trade should be balanced with individual trading partners, and the real concerns behind contrary arguments are usually efforts to prevent or moderate import competition.

In Bangladesh it is often argued that the deficit is aggravated by India's protectionist policies that have hobbled Bangladesh exports to India. However, for the past eight years India's imports from the world as a whole have been growing at over 9 percent a year. Recently, each year's increase in imports has been exceeding Bangladesh's total exports. Many of these imports have been coming in over considerably higher tariff than the tariffs faced by Bangladesh exporters, owing to the excessive tariff preferences given to Bangladesh by India under SAPTA, and to the extent that there are no tariff and bureaucratic barriers, they are probably more constraining than the ones that Bangladesh would face. This suggest that the low level and slow growth of Bangladesh's exports to India reflect fundamental comparative advantage factors, although discriminatory import policies prevailing. In this backdrop, different studies examined likely impact of free trade between India and Bangladesh. The general finding of the studies is that to some considerable extend of India's import regime are retarding Bangladesh exports. Under the circumstances of India's prevailing policies, potential for expanding exports to India is not very great, even under an FTA or with the full implementation of SAFTA.

8.3 India's Trade Policies

8.3.1 Non-tariff barriers

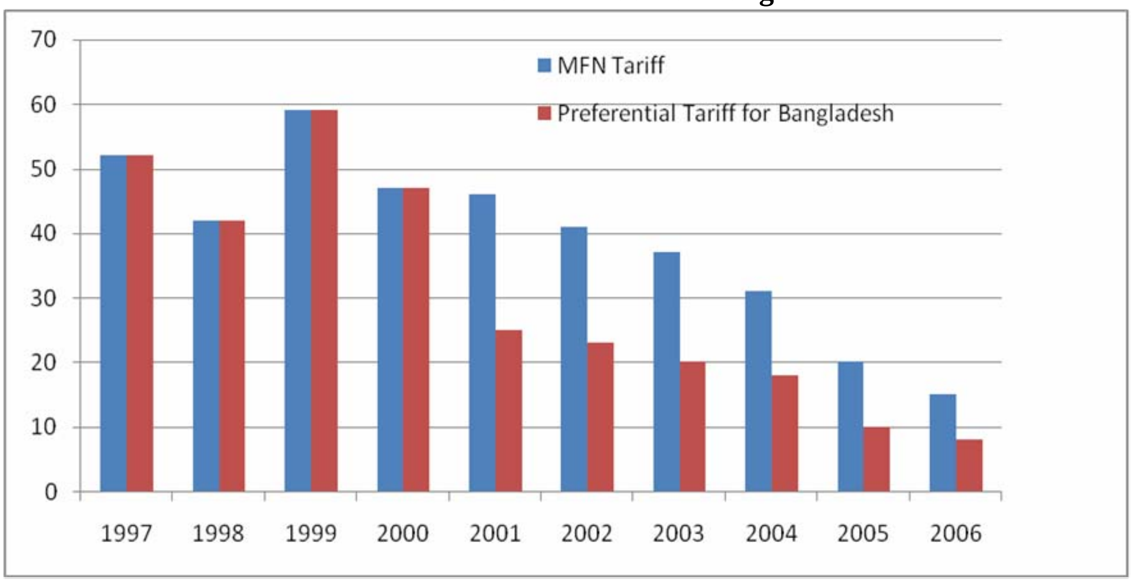
India's licensing restrictions on imports of raw materials and manufactured intermediates were removed to some extend during its 1991-92 reforms, but imports of nearly all industrial consumer goods and agricultural products continued to be restricted, either by import licensing which operated as a *de facto* import ban in most cases, or especially in the agricultural sector, by 'cancellation' through parastatals such as FCI. These restrictions were further removed in April 2001.

Against a background of almost 40 years of *de facto* autarchy, the abolition of this comprehensive import licensing system created considerable apprehension as to how well local producers of industrial consumer goods and of agricultural products would be able to compete with imports. Partly because of this apprehension, after the Uruguay Round, India is making sure to implement all the WTO-compatible procedures that allow non-tariff restrictions to be applied to imports.

8.3.2 Tariffs

As well as removing QRs from intermediates and capital goods, the 1991-92 reforms reduced tariffs and pre-announced a tariff reduction programme. Under this programme tariffs came down steadily from prohibitive levels at the beginning (average almost 130% in 1991-92) to much lower levels (average about 35%) in 1997/98 (Fig 1). However, in 2000, *ad valorem* tariffs were supplemented by the introduction of prohibitively high specific tariffs to protect textile fabric and garment producers.

Figure 8.1: India 1996-96 to 2005-06 Example of a typical industrial tariff. MFN rate and Preferential SAFTA rate for Bangladesh



Only a year after the removal of import licensing, a new tariff reduction process started in 2002-03. This new programme focused on industrial tariffs. There were three major omissions:

- Agriculture, livestock, fisheries and processed foods (HS 01-24)
- Textile fabrics and clothing products, about half of which continued to be protected by specific tariffs
- A few important manufacturing sectors, notably the auto and fertilizer industries

For most industrial goods, there was a significant tariff reduction in 2004-05 and 2005-06. 90 percent of industrial tariff are now 12.5%, far lower and far more uniform then they have been in the past 50 years. But it needs to examine whether the products came under tariff reduction covers the Bangladesh's exportables to India. From the perspective of SAARC countries including Bangladesh, these changes in tariff regime, if no technical barrier adopted, mean that Indian domestic markets for most manufactured goods are highly competitive, with prices that are close to world prices, and likely to be difficult to penetrate even with complete exemption from Indian tariffs under bilateral or multilateral free trade arrangements such as those planned under SAFTA.

In contrast to industrial tariffs, tariffs on agricultural products (defined in the broad sense to include fisheries, livestock and livestock products, agricultural products and processed foods) were left out of the new tariff reduction programme- in 2005-06, on average, they were about 40%, more than three times the level of non-agricultural tariffs.

8.3.3 Specific Duties Protecting the Textile and Garment Industries.

Just before the withdrawal of import licensing from textile and garments in April 2001, the government imposed specific duties on a large number of textile fabrics and garments, in order to protect domestic producers against low price import competition. At present these tariffs are the greater of the standard 15% rate, or the specific amount (usually Rupees per of per kg, or per garment). This system was designed to make it impossible or very difficult for other developing countries with strong textile and garment industries to compete in India. It also has the effect of excluding the products to which the specific duties are applied, from subsequent reductions in *ad valorem* tariffs. Readymade garments are Bangladesh's principal export, and these specific tariffs in India are of special concern to it in the context of regional trade arrangements including SAPTA and SAFTA. Given the low margins between fabric costs and garment export prices, tariffs at this level make it very difficult for Bangladesh RMG exporters to compete in India.

8.3.4 India's SAPTA Preferences for Bangladesh

Though SAFTA took effect from 1 January 2006, superseding SAPTA, tariff concessions offered under the latter remain valid until the completion of the Trade Liberalization Programme of SAFTA. At present India has given preferences to Bangladesh on approximately 2925 tariff lines, about 58% of the total number of its approximately 5000 6-digit HS lines. Two third of these preferences were agreed in the third SAPTA negotiating round and came into force during India's 2000-01 fiscal year. A majority of the preferences are special "LDC-only" preferences- most of these are 50%, some are 60%, and a few 15%, 75% and 100%.

In practice Bangladesh is the only relevant beneficiary of India's LDC-only SAPTA preferences, since Nepal and Bhutan have long had duty free access to the Indian market under their bilateral treaties, and the Maldives trade in negligibly small (at least from India's perspective). Therefore, in a sense, these preferences constitute a *de facto* bilateral asymmetric preferential trade arrangement between India and Bangladesh, asymmetric because many substantial preferences have been given by India, but for all practical purposes few and negligible preferences for Indian imports have been given by Bangladesh.

In order to qualify for India's SAPTA preferences, products imported from Bangladesh would have to satisfy the SAPTA origin rule, which is that the c.i.f. value of non-SAPTA imported inputs included in the exported products should not exceed 70% of the fob price. This provision is set extremely important for firms in Bangladesh wishing to export woven garments to India, reasoning that value-added margins in cutting, sewing and assembling garments from imported fabrics are typically around 30% of fob prices, and may be less. To get around this constraint, they can be use imported Indian fabric, even though they might not have done so if they had a free choice unconstrained by this consideration.

Anti-dumping (AD) is one of the WTO-legitimate measures that India introduced during the 1990s, as a way of providing extra protection as its tariffs came down and its import licensing system was dismantled. By the late 1990s and early 2000s, India had become the world's most active user of anti-dumping. However, there are recent indications that AD activity has been slowing the number of new cases brought during 2003-04 was 14 compared to 30 in each of the previous two years.

So far, there have only been three cases involving SAARC countries, two in Nepal, and one in Bangladesh. The Bangladesh case was finalized in December 2001, and involved Indian imports of lead acid vehicle batteries from Japan, Korea, China and Bangladesh. Anti-dumping duties were imposed on all imports from the four countries, and in the case of Bangladesh firm these were prohibitive and blocked all subsequent exports to India.

As regards Bangladesh's trade with India, the large number of Indian AD cases against exporters in China and other countries, and (except for the acid battery case) the absence of AD actions against Bangladesh exporters, is an advantage for Bangladesh exporters by sheltering them to some extent from the competition of these other exporters. However, most probably this situation principally reflects the absence of Bangladesh exports.

Were they to expand, even if their shares in the Indian markets of individual products were small, the exporting firms face the risk that they will be caught up in Indian AD actions mainly concerned about imports from other countries, as happened in the acid battery case. The best strategy for reducing the likelihood that AD cases will be brought, and for minimizing the damage if they are, is to follow low protection policies in the domestic market.

8.4 India's Export Policies

India operates a comprehensive set of export policies. Three aspects of these policies that are relevant for India's trading relationship with Bangladesh in the context of a bilateral FTA of SAFTA are described below:

- India restricts the Customs posts which can administer its various import duty neutralization schemes, and in June 2005 it was reported that Duty Exemption Pass Book (DEPB)- which is one of the most widely used – was not available at any of the land border Customs posts with Bangladesh except at Petrapole.
- Rebates for exporter under these schemes have been substantially reduced during the past five years as tariff levels have declined. These reduced rates mean that Indian domestic prices of exportable garments (as well as of other exportables) are likely to be not far above fob export prices, and may be below c.i.f. prices, increasing the difficulty for Bangladesh exporters to compete in the Indian market, even under FTA.
- In recent years India has demonstrated that it is willing to subsidize its exports of rice where there have been large domestic surpluses. In some years India's exports were large relative to the narrow international market and probably reduced world prices, with resulting economic welfare benefits to Bangladesh as an importer.

8.5 Bangladesh's Trade Policies

8.5.1 Non-tariff Barriers

During the late 1980s and early 1990s, import-licensing system was abolished. Of the continuing QR restrictions, the most important were the parastatal import monopoly over sugar and ban on textile fabric imports for use in the domestic market, which protected the textile industry. The sugar import monopoly was removed in September 2003 and the import ban on textile fabrics in January 2005, both being replaced by very high tariffs. But there are still QRs on the import of chicks, eggs, salt etc. Various permits, clearances and approvals are also required for extensive lists of other products, even though they are not formally subject to import licensing.

8.5.1.2 Customs Clearance at Land Border Customs Posts

The land border trade is subject to very serious administrative constraints in Bangladesh, because 38 out of 42 land border customs posts with India severely restrict the imported goods that can be cleared, and only four land border posts can clear all imported goods. In terms of volume the most important by far of the customs posts with comprehensive customs clearance power is at Benapole, which borders Petrapole at the Indian side and which is on main roads linking Kolkata with Jessor and Dhaka. In addition to these general constraints on imports by the land border, both Bangladesh and India have periodically constrained imports of certain products by specifying the ports at which they can be cleared by Customs. This in turn provides a strong incentive to send the goods illegally, either by "bootleg" smuggling which bypasses the Customs posts altogether, or by "official" smuggling involving bribes to Customs and other officials on both sides of the border.

8.5.2 General Tariff Trends of Bangladesh

The drastic tariff reductions of the early 1990s stalled after 1995/96, and during the following ten years up to 2004/05, tariffs declined only slightly. Average industrial tariffs came down modestly but the average protective rate for agriculture (including fisheries, livestock and processed foods) was 32.7% in 2004/05, slightly higher than it had been 10 years earlier. By July 2006, the unweighted average protective rate over all tariff lines declined by 7.7 percentage points, from 32% to 24.3%.

8.5.3 Para-tariffs

This slowing of tariff reduction occurred because continuing cuts in Customs duties were offset by increases in the scope and levels of a variety of para-tariffs which were imposed on top of Customs duties. By 2004/05 about 40% of the un-weighted average protection level was due to paratariffs, and para-tariffs were being applied to 21% of total tariff lines.

The para-tariffs have been principally but not exclusively used to provide extra protection to domestically produced consumer goods. As a result, during the 10 years since 1995/96 there has been no downward trend in the average protection rate of consumer goods despite reductions in Customs duty rates during the period and the discontinuance of the license fee in 2002/03. By contrast the average protection rates on basic raw materials, intermediate goods and capital goods are much lower, and in the case of raw materials and intermediate goods have been trending down since 1998/99.

"**End user" tariff concessions**: As well as using the para-tariffs to raise the protection for the outputs of domestic industries, the government has developed a system of special "end user" tariffs which provide low concessional tariffs on the inputs and capital equipment for specified industries or for specified uses. These concessional tariffs are much lower than normal MFN tariffs, and in the case of machinery and parts used by exporters, the concessional tariff is zero. However, there are only two major industries which receive special end-user concessions for their intermediate materials, namely the pharmaceutical industry and the insecticide industry. Bangladesh has well developed systems (mainly export processing zones and bonded warehouses) for providing duty free intermediate materials for its export firms, and this is not handled as part of the "end user" concessional tariff system.

Agriculture, livestock, fisheries and processed food: Bangladesh's trade policies in these sectors warrant separate treatment because, as in India, they differ in important ways from its manufacturing trade policies, in addition to which Indian agricultural products are generally a large although fluctuating share of its total exports to Bangladesh.

The high protection rates for some of the agricultural and other primary products, but especially of processed foods, from the viewpoint of Bangladesh consumers constitute a substantial and highly regressive indirect tax. This has important implications for the likely economic effects of an FTA with India, because if Bangladesh were to import these products duty free there could be large economic welfare benefits for Bangladesh consumers, but also difficult adjustment problems for the Bangladesh producers that lose protection. By contrast, it is probable that not much would change for Bangladesh consumers or for producers, if rice and Bangladesh's other cereal crops were included in an India-Bangladesh FTA, because of the Bangladesh protection levels that are already quite low.

8.5.4 Bangladesh's Tariff Preferences for India

Bangladesh gives tariff preferences to imports from India under the Bangkok Agreement and under SAPTA. Overall, the tariff preferences Bangladesh has given to India (and to the other member countries) under both the Bangkok Agreement and SAPTA are purely symbolic- their main effect has been to further increase the complexity of the tariff schedule and Customs administration rather than to provide any substantive preferences for imports from India of any of the other Bangkok Agreement or SAPTA countries.

8.6 Bangladesh's Export Policies

Bangladesh's exports are dominated by ready made garments, most of which are exported to the US and the EU. Nearly all garment exports are from firms operating in export processing zones or as bonded warehouses. In both cases they can import their textile and other inputs free of Customs duties and all other import taxes (including the 3% advance income tax) with the use of "back-to-back LCs" i.e. letters of credit based on LCs issued for their exports. As noted previously, machinery used by exporters is also exempt from all import taxes under the "capital machinery" provision for exporters. There is also a 5% subsidy on domestic fabrics used by garment exporters. Apart from these, there is a standard array of duty neutralization schemes (e.g. duty drawback) and export incentives (e.g. preferential export credit) and export promotion institutions and activities of the kind used in many developing countries.

8.7 Bangladesh Exports to India: Composition, Trends and Prospects under an FTA

Since 2001-02 Bangladesh's officially recorded exports to India have been increasing fairly rapidly, and the increase was sustained until fiscal year 2005-05 when it rose to around US$ 200 million. However, it was from a very low level of only US$50-60 million in FY 2001-02. It is still a miniscule share of India's total imports (less than 0.1%) and only about 1% of Bangladesh's total exports. About two thirds of Bangladesh's exports to India consist of just two products, anhydrous ammonia (which is imported duty free as inputs to India's urea industry) and raw jute. According to the various informal trade surveys, smuggled merchandise exports from Bangladesh to India by the bootleg route are also very low. The very low level and slow growth of Bangladesh's exports to India to some extend due to the restrictive import policies of India.

- For industrial products without SAPTA preferences, Indian industrial MFN tariffs came down from 44.9% in 2001-02 to 30.8% in 2003-04, to 20% in 2004-05, and to 12.5% in 2006-07. Despite this steep decline only 7 Bangladesh industrial products without SAPTA preferences appear in India's 2003-04 import basket, and then at very low annual import levels of no more than US$ 300,000 per product. The reasons behind this slow response are subject to extensive study to examine whether any technical barrier is preventing the Bangladeshi exporter to penetrate into the Indian market.

- Most of India's 2925 (HS 6-digit) SAPTA preferences for Bangladesh are on industrial products, and the most frequent concession rate is 50%. Assuming this preference rate, a typical Indian industrial preferential tariff for Bangladesh has declined during the past five years from 23% to 7.5%. Despite this, only seven industrial products with preferences appear among India's principal imports from Bangladesh in 2003-03, and the imports from each of these were less than US$ 500,000. This almost complete absence of response of Bangladesh exports to the numerous and fairly substantial Indian preferences under SAPTA, and to the decline of the preferential tariffs over the period, suggests that currently Bangladesh producers are probably not producing many products that are in demand in India or Indian counterpart industries are protected in some other ways. Or, might be the case that similar products which are being produced in Bangladesh, despite declining Indian tariffs, if no other technical or non-technical barriers are preventing, Bangladesh producers' costs are too high to compete with Indian producers, or with exporters in other countries who have to pay the higher MFN tariffs.
- Three quarters of Bangladesh's exports are ready made garments, most of which go to the USA and Europe. Bangladesh RMG producers appear to have a marked labour cost advantage over RMG producers in India, owing to lower wages and similar labour productivity, but India's specific duties on garments appear to have prevented any substantial penetration of its domestic markets by developing country clothing producers including Bangladesh. Under SAPTA, Bangladesh RMG benefits from Indian preferences- mainly either 50% or 60%- and these are applied to reduce both the *ad valorem* and the specific components of compound tariffs. Presumably helped by this protection and the SAPTA preference advantage, Bangladesh RMG exports to India- almost entirely woven cotton shirts- grew fairly rapidly after 1999-2000 up-to 2003-04, but the total level in that year (US$ 4.57 million) was still tiny both in relation to the Indian domestic RMG market and to Bangladesh's total RMG exports. This suggests that high protection levels provided by India's specific duties on garments are mostly redundant by wide margins. That is, actual domestic prices in India are probably not far above and may even be below prevailing international prices at the c.i.f. stage in India. It is also relevant that Sri Lanka, which is a major

RMG exporter – has had very negligible RMG exports to India, despite the 75% preferences for garments negotiated under the Sri Lanka India FTA. This low level of RMG exports to India by other member countries of SAFTA requires in-depth studies.

In general, India's import policies for 'agriculture' products have been and remain much more protective than its industrial protection policies, and in their present form they preclude substantial Indian imports from Bangladesh or from any other country.

How about the prospects for Bangladesh exports to India under an FTA or under SAFTA in which Bangladesh exporters would have duty free access to the Indian market would not be subject to Indian NTBs (such as its agriculture import monopolies), while India's existing tariffs and import policies would remain in the place with respect to the rest of the world? Based on the performances of Bangladesh's existing industries, the short to medium run prospects for expanded exports to India even in such favorable circumstances appear to be quite modest. The most obvious apparent opportunity would appear to be in RMGs, but:

- India is also a major exporter of RMGs, in 2003-04 with exports of US$ 6.2 billion versus Bangladesh's exports of US$ 4.9 billion. Indian domestic prices of exportable garments appear to be close to or even below c.i.f. prices.
- The likely difficulties of competing in India are compounded by the absence of a competitive low cost textile industry in Bangladesh, more so for fabrics than for yarns. This mean that RMG firms exporting to India would have to deal with the usual delays and difficulties of international procurement of their textile inputs, whereas the Indian firms with which they would be competing would in general obtain their inputs at highly competitive prices nearly in the domestic Indian market.
- In order to satisfy whatever rules of origin would be agreed under the FTA, Bangladesh exporters would probably need to source some of their textile inputs in India. If that turns out to be the case, it would be crucial to ensure fast and low cost transport and Customs clearance of the textile inputs obtained from India, preferably over the land border. Otherwise, if costs are high and there are unpredictable delays, Indian traders will be deterred from ordering garments from Bangladesh rather than in India.

- If the Indian RMG market were to be opened preferentially to Bangladesh exporters on a free trade basis, and Bangladesh exporters were able to take advantage of the opportunity, it is likely that some of the RMG exports that go to India will be diverted from other markets. Hence, not all of the increase in RMG to India would represent a net increase in total Bangladesh RMG exports.
- The RMG market in India is far larger and more diversifies than RMG production in Bangladesh. Even so, because of the importance in product differentiation in final consumer goods like garments-style, fashion, brands etc-some Bangladesh producers might be able to find market niches in India if they are able to link into strong Indian marketing organizations. However, the reverse is also the case, and under an FTA with India, RMG exports from India to Bangladesh based on these considerations could be substantial.

It is also important to consider the export prospects in India under an FTA of Bangladesh's principal secondary exports and also finds that the prospects for exporting these products to India under an FTA appear to be quite limited. This is because (1) the Indian tariff on the products that are currently being exported to India in non-negligible quantities-fertilizer and raw jute- are zero and 2.5%, so an FTA would make little difference; (2) export of the other products to India are zero or negligible despite low Indian preferential tariffs in most cases; (3) with some exceptions, exports would have to compete in India with Indian firms that are exporting themselves and are likely to be highly competitive in their domestic markets.

These apparently very possibilities for Bangladesh to find substantial export markets in India under an FTA for its present exportables by diversifying and developing some of industrial products that Bangladesh might have comparative advantages. New product development could be accelerated and distribution and marketing in India facilitated by direct investment including joint ventures or the part of Indian firms.

8.8 Trade Financing, Logistics and Transaction Costs

A study of the financing of India-Bangladesh trade points out that the hawala networks (borrowing money from relatives or non-formal, non-institutional sources) perform better than the formal banking system in terms of simplicity, speed, transaction costs and reliability, and that for these reasons they are not only financing much of the informal bootleg smuggling trade from India to Bangladesh. It notes that under Bangladesh Bank rules LCs are compulsory for all import consignments in excess of US$ 5000, but involve very high transaction costs, mainly due to credibility problems of Bangladesh banks and resulting high confirmations charges by prime US or other international banks. As a result, in practice “the LC is a mere cover to move goods through the Customs”.

8.9 Implications for Bangladesh and Indian Trade Policies

8.9.1 Implications for Bangladesh

The stimulated economic effect of an India-Bangladesh FTA in the industry case studies which predict Indian exports to Bangladesh, all indicate large economic welfare gains from Bangladesh consumers which far outweigh the total government revenue losses, producer surplus losses resulting from the contraction of Bangladesh production, and losses of economic rents in Bangladesh resulting from the contraction of both “bootleg” and “technical” smuggling. In addition an FTA would also generate some Bangladesh producer surplus gains from expanded exports to India, but there are likely to be quite limited owing to the highly competitive nature of most Indian markets. All these presupposes that infrastructure and administrative capacity would be greatly improved and expanded on both sides of the land border crossings to reduce bottlenecks and to stay ahead of the expanded bilateral trade, otherwise the economic welfare gains from the FTA would be severely compromised by increasing congestion, delay and informal payments.

The prediction that an FTA with India could bring large net economic welfare benefits for Bangladesh must be qualified by some important risks:

- By providing a captive protected market to Indian suppliers, there is a risk that instead of exporting to Bangladesh at prevailing world prices, the Indian producers will collude with each other and possibly with some Bangladesh producers and set prices that will transfer most of the economic benefit of the FTA arrangement to India. If prices are sufficiently high there could be a net economic welfare loss for Bangladesh, with consumer surplus benefits insufficient to outweigh government and producer surplus losses.
- There is a risk of terms of trade losses for Bangladesh if, following the FTA, some Indian industries export to Bangladesh at competitive prices which are nevertheless higher than prevailing world prices.

- In the recent past India has subsidized its exports of rice, wheat and sugar in order to get rid of excess stocks generated by problems with its domestic support and other policies. Bangladesh has benefited from these subsidies by importing Indian supplies of these commodities at the subsidized prices. However, if Bangladesh were a captive market for these products under an FTA, India would be able to supply Bangladesh at whatever higher prices would be possible given the Bangladesh MFN tariffs, probably involving lower or zero Indian export subsidies. Under an FTA, Bangladesh might also forego similar benefits in importing other commodities subject to similar cyclical production and world price pattern.

These risks for Bangladesh of an India-Bangladesh FTA are substantial and serious, and raise the importance to obtain the same economic welfare gains by forming a policy of multilateral import liberalization, which could produce the same consumer surplus benefits for Bangladesh consumers and the same net domestic economic benefits by avoiding the risks. With multilateral import liberalization, there would be no producer surplus benefits for Bangladesh exporters from protected preferential markets in India, but the potential for these appear to be quite limited, owing to India's recent reductions of its industrial tariffs to quite low levels, and tariff redundancy in its protected agricultural, textile and clothing sectors. Multilateral import liberalization would also not disadvantage third countries, which in the case of Bangladesh are largely other developing countries. To implement such a policy, first priority would be to phase out the para-tariffs, eliminating first of all the use of the VAT and the supplementary duties as protection instruments, and moving towards a simple, low and uniform customs duty plus VAT import duty structure, along the lines of the structure currently in place for nearly all of India's industrial products.

8.9.2 Implications for India

India's trade with Bangladesh is very small relative to its total trade and to its economy, and so the economic welfare consequences of an FTA involving Bangladesh (whether bilateral or as part of SAFTA) are also quite minor even though they are significant for Bangladesh. There are potential producer surplus benefits for Indian producers and traders from the expansion of exports to Bangladesh that would result from an FTA, and these might be increased further if some Indian industries were able to effectively collude in supplying Bangladesh under the umbrella of high Bangladesh MFN tariffs. However, in such situations it would probably be unlikely that Bangladesh would maintain high MFN tariffs if the principal impacts of such tariffs would be to facilitate the transfer of economic rents to Indian suppliers. Furthermore, there would be offsetting losses of economic rents, including Indian indirect taxes, associated with smuggling networks on the Indian side of the boarder, given the likelihood that the FTA would divert trade to the legal routes.

In case of RMG there is the possibility of some Indian consumer welfare benefits from Bangladesh RMG exports to India under an FTA, but these and other potential consumer welfare benefits appear to be quite limited in view of the current general openness of India's industrial import policies, and the competitiveness of domestic production and prices in most of the sectors with high and very high import protection, notably agriculture products and the textile and clothing sectors protected by specific tariffs. In addition, any likely expansion of Indian exports to Bangladesh under an FTA is likely to be very small relative to relative to the total Indian market, with no or minimal impact on prices, except possibly in some boarder areas for some products. Consequently, Indian policy does not need to be concerned that export expansion to Bangladesh might produce significant consumer price increases.

All of these suggest that there is no compelling case for India's point of view to pursue an FTA with Bangladesh, based on the potential economic welfare benefits to India. Whatever economic benefits might result from an FTA with Bangladesh, are potentially available on a much broader basis and larger scale from continuing the general unilateral import liberalization process that has been under way during the recent years. This would pay special attention to non-tariff barriers and prohibitive tariffs in the agricultural sector (including livestock and fisheries products and processed foods) and to the specific duties protecting the textile and clothing sectors. In view of substantial tariff redundancy in most segments of these sectors, such policies would probably not require much producer adjustment and would provide some limited benefits to Indian consumers as well as some limited export opportunities for neighbouring countries including Bangladesh.

It could be argued that FTA and MFN liberalization could complement each other and that regional agreements are politically easier to institute and manage, and therefore they should go hand in hand. For this argument to be valid, regional cooperation must have reached a high level to prompt a virtuous cycle of protection reductions. There are problems on the Bangladesh side due to (a) the very high protection levels to its import substitution industries; (b) concerns about customs revenue losses from an FTA; (c) limited potential in the short to medium run at least for Bangladesh exports to India under an FTA; and (d) the extreme political sensitivity in Bangladesh stemming from the fixation on the bilateral trade deficit with India, which is likely to increase rapidly and substantially under an FTA. For these reasons Bangladesh would only go into a bilateral FTA with India (or into SAFTA) if India were to agree to extensive concessions while Bangladesh would insist on a very extensive negative list.

Additionally, the fiscal consequences in Bangladesh can be managed much more effectively and directly with multilateral trade liberalization than under a bilateral FTA (or under SAFTA), since if an FTA is actually implemented there would be zero custom duty revenue from imports from India, whereas MFN liberalization can be managed with phased tariff reductions. A second reason is that there are already serious administrative problem and complexities in the Bangladesh tariff regime even though Bangladesh's SAPTA preferences are negligible. These complexities would be greatly magnified if Bangladesh started to phase in substantial tariff preferences and eventually exemptions as part of an FTA. A third reason is that tariff reform in Bangladesh needs to focus on the removal of the para-tariffs. While in principle that could go on simultaneously with FTA negotiations, the process would be much more complex, especially with regard to "sensitive" negative list industries. A fourth reason is that Bangladesh multilateral liberalization won't create a lopsided increase in the bilateral trade deficit with India: imports from India will increase, but along with imports from other countries. Finally, with general import liberalization there would still be an opportunity cost of not dealing with the trade infrastructure along the land border with India, but it wouldn't be concentrated there. It would also create pressure to deal with the infrastructure and administrative capacity at the seaport.

8.10 India-Bangladesh Co-operation in Other Areas

The suggestions above that both India and Bangladesh would obtain greater and more secure economic benefits by giving priority to unilateral trade liberalization on a multilateral basis, rather than by pursuing free trade arrangements, does not mean that other trade-related cooperative endeavours should be neglected. In particular, there would be substantial benefits from coordinated improvements in transport, storage and administrative infrastructures at and adjoining the India-Bangladesh land borders, as well as harmonization and cooperation in customs administration and banking relationships. As well as facilitating bilateral trade and reducing its costs, this would help reduce black economy activities in both countries associated with both the “bootleg” and “technical” smuggling routes, and improve fiscal resources, especially in Bangladesh. Finally, there is little doubt that regional cooperation in infrastructure could yield dividends in term of cross boarder investments and joint ventures.

CHAPTER IX

POTENTIALS TO ENHANCE TRADE IN OTHER SECTORS AND TO MARKET ACCESS

9.1 Introduction:

In the face of challenges of open market economy and globalization, the government believes that private sector-led industrial development could be one of the prime movers of economic growth. Beside this, government, by now, has liberalized the trade regime by introducing a range of reforms so that the entrepreneurs can set up industries and operate them profitably without any misgivings. Meanwhile, the government has handed over a number of state owned enterprises (SOEs) to the private ownership. In order to establish economically viable industrial enterprises, the government has taken initiatives to set up Industrial Areas and Special Economic Zones (SEZs) so that the huge land area of these industrial zones is effectively used to set a new trend for industrialization that would facilitate creation of huge employment opportunities.

To further strengthen the process of industrialization, the government has identified the Small and Medium Enterprise (SME) Sector as a priority sector and also as an engine of industry. All facilities to be given to the potential investors, to attract foreign direct investment, were incorporated in the industrial policy. The government has formulated a separate SME policy to provide required guidelines and strategic support to set up SME industries across the country. Guidelines and strategies incorporated in the SME policy will be followed to establish SME industries.

Over the last decade, a discernible change across the globe was evident in terms of women's participation in socio-economic activities particularly in the sphere of industry. The present industrial policy, therefore, attaches significant priority to the issue of creating more women entrepreneurs and ensuring more participation of women entrepreneurs in the process of industrialization. For hygienic preservation and marketing of Bangladesh agricultural products steps will be taken to make them frozen, pasteurized, canned or turn them into dry food, so that all these locally produced commodities can be exported round the year.

In this age of ICT, it is possible to provide accurate and rapid customer services by using ICT for cost effectiveness and improvement of the quality of products. This is why, providing encouragement to the intensive use of ICT on certain specific areas is another important feature of the present industrial policy.

It is visualized that the industry sector that will be developing over the next decade would be able to gain 30-35 percent share of GDP and asks to absorb 35 percent of the labour force. To achieve this estimated growth in the manufacturing sector, the present industrial policy has laid special emphasis on strengthening efforts to establish agro-based and agricultural product processing industry, together with steps to face the possible adverse situation in export-oriented RMG industry and SMEs sector, to extend facilities to women entrepreneurs on priority basis.

Seizing opportunities for expanding market share and new markets and positioning Bangladesh's RMG industry to compete successfully with other competitors primarily involves changing domestic policies, practices and incentives. At the same time, Bangladesh should be seeking every opening available or in prospect to gain eased access for its products into US and EU markets and into the markets of countries like Canada, Australia and Norway which have granted duty-free access, and should even be actively exploring access to China and Japan, in addition to opening up export opportunities within the south Asia region, such as in India.

9.2 Preferential Access

As an LDC, Bangladesh has profited substantially from the EU grant of duty-free access for its RMG exports, but still faces average tariffs of 14 percent on goods sold to the US. Not only does the US not offer duty-free access to LDC exports, its tariffs are generally skewed against them to the point that Bangladesh paid more tariff fees on its apparel exports of about $2 billion in 2003 than French exporters paid on their exports of US$26 billion. By offering duty-free access to a number of Caribbean countries and African LDCs, moreover, the US has put Bangladesh exporters at a price disadvantage. Their response has been to lobby hard for the US Congress to give them duty-free access under a proposed bipartisan bill called Tariff Relief Assistance for Developing Economies (TRADE) Act 2005. That bill would help several least developed countries - not just Bangladesh – and the work of making the case for wider access is one that international organizations should be called on to support.

Were US tariffs eliminated, Bangladesh apparel exports are projected to increase by 90 percent in 3-4 years, and textile exports would grow by 82 percent. Gaining such a foothold and expanding market share in the lucrative US apparel market is every garment exporter’s dream, but Bangladesh needs to look at that prospect and preferential access in general with realism. It should take every possible advantage of the preferences it can gain, but also understand the conditions attached and the reality that it will not remain an LDC forever. It should use the time and latitude to prepare for increased competition when it graduates out of the LDC league.

9.3 Rules of Origin

An essential requirement for obtaining GSP facilities is that the export products of these beneficiary countries must satisfy the applicable rules of origin. Each developed country (or custom territory) has its own GSP scheme to provide preferential treatment to export products of developing countries and a set of origin to go with it. According to the current EU rules of origin, export items of apparel must be ‘manufacture from yarn’, implying that ordinary apparel items must be made from domestically produced fabric in order to obtain originating status. This requirement turns out to be fairly stringent. Most of the exported oven garments to EU are made from imported fabric and consequently do not satisfy the rules of origin. The discussion on the rules of origin in Bangladesh usually centers on the EU rules of origin applying to GSP (EBA) benefits. The reason for this exclusive focus on EU rules of origin is that Bangladeshi exports are prevented from fully utilizing GSP facilities because of RoO related problems only in EU. Bangladesh exports must meet a stringent test in the EU rules of origin requiring that apparel be made of domestically produced fabric to gain preferences. Currently only about one-half of the RMG exporters of Bangladesh are able access EU GSP facilities. Some Bangladesh products meet that test; others, made with imported materials, do not. RoO related problem does not occur in USA since it does not give any GSP benefits to textile and leather products, and other products such as shrimp easily meet the US preferential RoO. The RoO is also not a problem in Canada and Australia as these are now sufficiently liberal to permit all exports to obtain GSP benefits. There are little of RMG products exported to Japan or Norway and hence, RoO of these countries have not emerged as an issue at this moment.

The RMG producers have lobbied with EU for the last several years for a relaxation of the aforementioned rules of origin such that garments manufactured from imported fabric could also qualify for GSP benefits, but primary textile producers have opposed any relaxation and the government has also not supported their demand. So the EU has not relaxed the rules of origin. The inability of a large part of the LDC manufactured exports to cash on Everything but Arms (EBA) benefits has finally persuaded EU to reconsider the rules of origin. It is now contemplating changes in the rules to a simple value addition criterion such that more exports from LDCs qualify for EBA benefit. However, there exists a small window of opportunity to circumvent the rules of origin in the form of regional Cumulation, which permits derogation fro the provisions of Article 67 that define originating rules.

9.4 Regional Cumulation

While the EU reconsiders the application of its strict rule to LDC exporters in general, Bangladesh might be able, through the provision of regional cumulation, to get around the barrier to preferential access. A beneficiary country, which is part of a regional trade area such as SAARC may claim, for GSP purpose, fabric purchased from regional member countries as their own when claiming GSP if the value added there is greater than the highest customs value of the fabric used originating in any one of the other countries of the regional group and the working or processing carried out there exceeds certain minimum processing requirements. Beneficiary country being part of a regional trade may for claim for GSP - as long as the value added crosses a high threshold- effectively over 50 percent for Bangladesh – of the finished product. However, when these conditions are not satisfied, the product shall have the origin of the country of the regional group which accounts for highest customs value of originating products coming from other countries of the regional group. Most Bangladeshi woven goods cannot meet that test and manufacturers are not likely to restructure their current supply chain to benefit from the narrow opening. Since EU requires that respective Governments endorse the cumulation option, what is needed is for the Bangladesh Government to lobby for lower value addition criteria. Such a scheme offers incentives for sourcing inputs from the region, which, in and of itself, could be a way for reducing lead-time and enhancing competitiveness. Bangladesh should not pass up the opportunity.

The Cumulation rules clearly indicate that availing this facility depends on the cost structure of RMG production and the number of sources of imported inputs used in production. If fabric is imported from a single regional country (as is mostly the case) and all other inputs going into RMG production are sourced domestically, the domestic value addition must exceed 50 percent of the *ex works* price of the garments to qualify as originating domestic product under the Cumulation derogation. This is unlikely to happen as fabric value is typically over 60% of costs. Therefore, Bangladesh needs to request for further derogation from GSP rules of origin, as was done and granted to Cambodia, Laos, and

Nepal. That would allow Bangladesh zero-tariff access to EU as an LDC, while manufacturing operation takes place from there without any value-added condition.

9.5 Warehousing for Quick Turnaround

Given the very large investment required and an adverse international market situation characterized by over-capacity and low prices, there is little prospect of improving the domestic supply situation in the short or medium term enough to fill the gap between supply ad demand. An innovative approach, the establishment of a central bonded warehouse (CBW), can let local manufacturers match the lead-time of competing countries and do so quickly. A CBW differs from the individual bonded warehouse in that each CBW is permitted to stock duty-free imported inputs, while imports to it of duty-free RMG and textile raw materials would not be conditioned on master export LCs. In principle, the CBW operator could be permitted to stock up a whole range of T&C inputs such as finished and grey fabric, accessories, dyes and chemicals, yarn, RMG and textile machinery and spare parts in amounts determined by expected demand of RMG and textile manufacturing.

9.6 Taking Advantage of External Policy Environment

Make the most of preferential market access which gives price advantage: Bangladesh experience shows that preferential access to global markets creates price advantage that translates into more exports. As mentioned earlier, MFA quotas provided sheltered market access to Bangladesh garment exporters to US and EU, prompting the growth and expansion of an entire industry, and providing job opportunities to hundreds and thousands of unskilled labour, mostly women. On top of it, being a Least Developed Country (LDC) afforded Bangladesh the benefit of GSP plus zero tariff access to EU under Everything But Arms (EBA) scheme, though subject to some stringent rules of origin (ROO) requirement. While other developing countries like India and China were restrained both by quotas and non-zero tariffs averaging in access of 12%, Bangladesh exports which satisfies ROO requirements entered EU market duty-free, giving them substantial competitive advantage over competitors. The preferential margin greatly helped to increase the export to EU at a rapid rate. Indeed, more than 95 percent of the increase in the total knitwear exports of Bangladesh between 1997-98 and 2002-03 was accounted for by the increased exports to EU. Total knitwear exports were only about one-fifth of the total exports of woven garments in 1993-94, but by 2003-04 this ratio rose to more than three-fifths. By volume, knitwear exports now exceed woven exports. EU absorbs nearly three-fourths of the knitwear exports of

Bangladesh. Textile and apparel imports to the North American market (US and Canada) were not subject to GSP preferences. Consequently, Bangladesh apparel exports to US faced average tariffs of about 14%. In 2003, Canada offered zero tariffs accessed and relaxed ROO for LDCs. As a result, Bangladesh's exports of apparel went from US$90 million in 2002 to US$342 million in 2004- a fourfold increase of exports in just two years. This trend is continuing.

Although the above discussions have focused on staying competitive and seizing preferential access into the major export markets for RMG (US and EU), this is not to under-estimate the potential for exports to hitherto untapped markets, Japan, which is the largest importer of RMG, after US and EU, is yet to be explored, but holds enormous potential. Bangladesh needs to penetrate this market, but faces stiff competition from China. Vigorous marketing and promotion drives are needed to enter the Japanese, East Asian and other growing markets of middle income countries, not to mention Australia, New Zealand, and Norway, all of which have given zero-tariff access to Bangladesh exports. Even Russia and the Middle East hold significant prospects for future exports.

It is to be recommended that preferential access is time bound and comes with conditions. Bangladesh should seize the opportunities offered to it as an LDC but use the space to prepare for increased competition when it graduates out of the LDC league. The industry should be looking out for other markets beyond US and EU.

The current value addition requirement turns out to be prohibitive for most of the woven RMG manufactures. A number of studies including Dr. Martelli Associates (1999), Bhattacharia and Rahman (2000) and Gherzi *et al* (2002) show that the value addition in the production of the most common items falls short of the minimum required to qualify for EU GSP. In other words, without a substantial relaxation of the value addition requirement, most of the RMG exports to EU will not qualify for GSP *even if regional fabric is used.* Only the high value and fashion items, which account for a small part of the total RMG production could benefit from existing Cumulation rules. Notwithstanding this fact, textile manufacturers have strongly opposed Cumulation because of their apprehension that they would lose market share to Indian textile producers if Cumulation is allowed.

As stated earlier, the local woven textile sub-sector supplies about 15 percent of the total demand of the woven RMG sector. This sub-sector of Primary Textile Sector (PTS) has not been able to increase its share of the RMG requirement during the last several years since RMG demand has increased at a faster pace than the increase in their production capacity. Unless locally produced woven fabric is currently being used only to produce high value fashion items where value addition exceeds 50 percent and all of it is exported to EU, SAARC cumulation can have hardly any effect on the domestic producers. The privileged position, and consequently the price premium, enjoyed by the locally produced fabric due to the rules of origin for EBA will not be affected much by cumulation. Hence, it appears imprudent to pursue a policy that holds back RMG producers from taking advantage of regional cumulation.

It is to be recommended that regional cumulation, in whatever shape or form, offers incentives for sourcing inputs from the region, which, in and of itself, could be a way for reducing lead-time and enhancing competitiveness. Government should lobby hard with EU to reduce value added requirement along with liberal regional cumulation option.

An FTA with India could spur RMG exports to the vast Indian market. Access to the vast Indian market for readymade apparel without hindrance from tariff and non-tariff barriers could add a significant dimension to India-Bangladesh trade by opening a potential channel for addressing the bilateral trade gap that often is an eyesore in Indo-Bangladesh relations. An FTA that gives unilateral duty-free access to RMG exports (among others) from Bangladesh, with staggered reduction of duties for Indian imports, is an attractive option from the Bangladesh perspective. Whether such an arrangement can be pulled off in the near term is a political economy question.

Table 9.1: India and Bangladesh: Total Garments Exports 1997-2004

	India			Bangladesh		
Fiscal Year	Knitted	Not Knitted	Total	Knitted	Not Knitted	Total
	HS 61	HS 62		HS 61	HS 62	
1997	1034	2719	3753	763	2238	3001
1998	1023	2855	3878	940	2843	3783
1999	1258	3107	4365	1035	2985	4020
2000	1588	3177	4765	1270	3083	4353
2001	1769	3790	5559	1496	3364	4860
2002	1864	3143	5007	1459	3125	4584
2003	2387	3352	5739	1652	3255	4907
2004	2701	3541	6242	1859	3116	4975

Source: India: Department of Commerce, Export Import Data Bank, Bangladesh Bank and Export Promotion Bureau, Exports for Bangladesh FY04 are up to May 2004 only. The Indian fiscal year is from April 1 to March 30. The Bangladesh fiscal year from July 1 to June 30.

India and Bangladesh are two of the world's leading exporters of readymade garments. The RMG industries in both countries are very large, low cost, internationally competitive and economically efficient export industries. Therefore, the likely economic consequences of their inclusion in a free trade agreement –whether bilateral or under SAFTA- are of special interest. This is especially the case in Bangladesh, where many Bangladeshis hope that RMG exporters might help reduce Bangladesh's large bilateral trade deficit with India. But the economic effects of opening up RMG trade between the two countries in the context of an FTA are complicated by:

- India's prohibitively high specific duties on most garments
- Bangladesh's very high RMG and textile tariffs
- Bangladesh's ambiguous policies on domestic sales by exporting RMG firms

9.7 Tariffs Policy

Before the final removal of the textile and clothing import ban, with the support of the Ministry of Textiles, India's T&C industry lobbied the government to impose specific duties on a large number of textile fabrics and garments. This was done in 2000. In 2002/03, the proportions of HS 6-digit tariff lines subject to specific duties were: cotton fabrics, 49%; man-made filament fabrics 88%, man-made staple fibre fabrics 69%, special woven fabrics (including tare cord fabrics) 51%; knitted apparel 30%; apparel, not knitted 62%. The tariffs are compound i.e. the higher of an amount calculated using an ad valorem rate or the specific amount. The specific component is in Rupee per square metre or per kilo in the case of fabrics, and per item (e.g. per shirt) in the case of garments. For the products subject to specific duties, the objective and effect is to target and keep out imports of specifications and quantities that sell for low prices for which there is the largest demand in the Indian domestic market, and of which other developing countries are the most competitive foreign suppliers. The specific tariffs were initially set at very high levels during FY 2001 they were reduced somewhat in FY 2002 and have remained at that level since. The FY 2003/04 Customs tariff schedule extended the HS classification system from 6 to 8 digits, and in doing this the specific duty for any given 6-digit product was also used for its 8 digit sub-products.

Table 9.2: India. Men's or boys' woven cotton shirts: MFN tariffs and SAPTA preferential tariffs on imports from Bangladesh. Comparisons of ad valorem equivalents of specific tariffs, 1999/2000-2005/06

	Ad valorem rates		**Specific tariff ad valorem equivalents**					
			$3 shirt		$4 shirt		$5 shirt	
	MFN	Pref	MFN	Pref	MFN	Pref	MFN	Pref
1999/00	45.7	45.7	45.7	45.7	45.7	45.7	45.7	45.7
2000/01	44	24	106.5	55.2	80.8	42.4	65.5	34.7
2001/02	40.8	22.6	66.3	35.3	50.8	27.6	41.5	22.9
2002/03	35.8	20	65.4	34.9	50.1	27.2	41	22.6
2003/04	35.8	20	68.6	36.5	52.6	28.4	42.9	23.6
2004/05	20	10	63.1	31.6	47.3	23.7	37.9	18.9
2005/06	15	7.5	63.1	31.6	47.3	23.7	37.9	18.9

Note: There were no SAPTA preferences for garments in 1999/2000 and before, and no specific duties. From 2000/01 the Bangladesh SAPTA preference has been 50%, but that only applies to the Indian "Basic" Customs duty. Consequently, until 2004/05 the preferential tariffs were more than 50% of the MFN tariffs owing to the application of other protective import duties. The last of these other duties (the Special Additional Duty or SADD) was removed in January 2004. A small "education cess" (2% of all import duties) introduced in 2004 has not been allowed for.

Under SAPTA, preferences for garments were introduced in FY01- but for "least developed" SAPTA countries only. Subject to meeting rules of origin, the preference for Bangladesh and the other SAPTA LDCs (Nepal, Bhutan and Maldives) on most garments is 50%, so the basic Customs duty would be the greater of an amount calculated by applying half the ad valorem rate to the cif price, and half the specific amount. The preferences did not apply to India's "Special additional duty" (Sadd). In most circumstances the Sadd provided significant extra protection, so the preferential protection rate was greater than implied by the apparent preference. For example, in 2002/03 the MFN ad valorem protective rate on garments (including the effect of the Sadd) was 35.8% and the preferential protective rate on imports from Bangladesh was 20%. The Sadd was abolished in January 2004. There are no garment tariff preferences for the other "developed" SAPTA members i.e. Pakistan and Sri Lanka. However, under the bilateral agreement with Sri Lanka (ILFTA) the preference for garments imports from Sri Lanka is 75%, and garment imports from Nepal (like imports of nearly all other products) are duty free. In order to qualify for the SAPTA preferences, garments imported from Bangladesh would have to satisfy the SAPTA origin rules. For the SAPTA LDCs the principal requirement is that the c.i.f. value of non-SAPTA imported inputs included in the exported product should not exceed 70% of the fob price, or put another way, that national value added should be no less than 30% of the fob price.

9.8 Prospects of Bangladesh's Garment Export to India

Three important factors which affect the ability of Bangladesh garment firms to export to India with the present SAPTA preferences or hypothetically in the future with a free trade agreement, are: (1) production costs in Bangladesh relative to production costs in India; (ii) India's tariffs in relation to the Bangladesh cost advantage, if any; and (iii) whether and how the Bangladesh firms satisfy rules of origin.

9.10 Production Costs-Bangladesh vs. India

Studies of export firms in major garment exporting countries consistently indicate that Bangladesh has the lowest wages, and that the advantage this should give Bangladesh garments firms over in other developing countries (including India) is not offset by lower labour productivity.

Table 9.3: Comparisons of Labour Costs and Productivity in the RMG Industry

	Labour cost $US/hour	Minute per Woven dress shirt	Implied labour cost $US/shirt	Minute per pair of Jeans	Implied labour cost $US/pair of jeans
Bangladesh	0.23	61	0.23	62	0.24
India	0.41	63	0.43	65	0.44
Pakistan	0.37	65	0.40	70	0.43
Sri Lanka	0.35	50	0.29	55	0.32
China	0.77	60	0.77	60	0.77
Indonesia	0.41	n.a.	n.a.	70	0.48
Vietnam	0.30	65	0.33	65	0.33
Total	14.71	35	8.59	35	8.59

Note: Labour costs and productivity estimates from Gherzi report (2002). Implied labour costs calculated from these numbers. The productivity comparisons are for the same technology levels except in the case of Italy.

The implied direct labour costs derived from these comparisons suggest that for dress shirt and jeans Bangladesh has a labour cost advantage of about US 20 cents per unit over India. Generally lower wage levels in Bangladesh also presumably mean that –provided productivity is similar or better – clerical and other overhead labour costs are also lower in Bangladesh than in India, and this would also apply to transport and other expenses if these services were equally or more efficient. Even so, relative to typical selling prices, the likely cost differences are minor and could easily be offset, or more than offset, by differences in other costs, or in quality, design, delivery times and other non-price factors. Certainly, they do not provide a decisive cost advantage comparable to the cost advantage that Bangladesh and other developing countries have over garment producers in developed countries, as illustrated by the direct labour cost per shirt in Italy ($8.59) versus US 23 cents per shirt in Bangladesh. Relative to prices, the 20 cents production cost advantage over India is only 6.6% of the price of a shirt selling for $3, and 4% of the price of a shirt selling for $5. Relative to margins (fob prices over input costs), the difference is greater: about 20% of typical woven shirt margins of about $1/shirt, but even if there were an FTA this difference still appears to be too small to be a major influence on sourcing decisions.

9.10 Cost advantages and Indian Tariffs

It is also instructive to compare the apparent labour cost advantage of garment production in Bangladesh with India's tariffs, especially the specific tariffs. For woven shirts, for which the apparent labour cost advantage is about 20 cents, in 2004/05 the Indian specific tariff on a shirt imported from Bangladesh was 92 cents, and on a man made fibre shirt it was about $1.31. These tariffs far outweigh the Bangladesh labour cost advantage, and unless the Bangladeshi shirts had some special style, brand, marketing, or other advantage, would appear to preclude imports of low value shirts, at least on a substantial scale. Most of the garments which Bangladesh exports to developed countries in large quantities are subject to specific duties in India, and even though India's SAPTA preferences for Bangladesh cut most of these duties by 50% (and few by 60%), the preferential duty in most cases is still much too high to allow substantial exports from Bangladesh to India.

Table 9.4: Price of some Bangladesh exported RMGs and Preferential Tariffs for Bangladesh Imports in India

	Prices & tariffs in $US/garment			
	Export Price	CMT Price	Specific duty	Ad valorem duty 7.5%
Polo Shirts	2.53	0.96	0.98	0.19
T-Shirts	1.45	0.38	0.52	0.11
Sweaters	3.58	n.a.	0.98	0.27
Jogging Suits	9.79	n.a.	None	0.73
Nightwear	3.5	n.a.	None	0.26
Pyjamas	2.33	n.a.	None	0.18

Note: Prices from Gherzi report, Ch 4, p.64. HS classifications are not given, so the Indian tariffs may vary from these e.g. depending on the predominant material used.

The above Table shows current Indian 2005/06 tariffs in relation to typical export prices of a few Bangladesh RMGs. The specific duties on knitted polo shirts and T-shirts, which are two of Bangladesh high volume exports, are higher than typical CMT prices i.e. the prices quoted to cut, make and trim from fabric provided by the buyers, so it is unlikely in the extreme that an Indian trader would ever source these garments in Bangladesh if comparable prices could be obtained from suppliers in India (and even less likely to source from China or some other MFN suppliers for which the specific tariffs are double the rate applied to Bangladesh e.g. $1.04 for a T-shirt selling for $1.45 fob and with a CMT price of US 38 cents). The products just subject to the preferential 7.5% *ad valorem* would have a better chance of competing in India, but for low value products even these duties would probably make life difficult for Bangladesh suppliers. For example, if India were to remove the specific duty on Bangladesh T-shirts, the *ad valorem* duty for Bangladesh suppliers would still be around 30% of the CMT price. For these reasons, given the highly competitive Indian RMG industry, Bangladesh garment exporters would probably need duty free access to India to have much hope of winning substantial market share in high volume products. If India abolishes the specific duties, even at the current reduced *ad valorem* tariffs and with a substantial advantage over MFN suppliers, export prospects would be modest, and if the present specific duties are maintained, Bangladesh suppliers would probably be confined to small, mostly specialized or opportunistic fringes of the Indian RMG market.

For the SAPTA LDCs (Bangladesh, Nepal, Bhutan, and the Maldives) to obtain tariff preferences in exporting to India, the maximum material input content (valued at cif prices) that can be imported from non SAPTA countries, is 7% of the fob price. In this respect, Bangladesh has an advantage over Pakistan and Sri Lanka, for which the maximum imported content is still 60%. As is usual in preferential trading areas, the minimum local content requirement can be met by importing materials from other SAPTA members, but subject to the additional constraint that if this is done, the content requirement increases to 40% of the fob price. For Bangladesh firms exporting to India, this means that if they use imported materials from India to help satisfy the SAPTA origin rule, they have to buy sufficient of these materials to raise the regional content (i.e. processing costs and Bangladesh materials, plus the materials imported from India) to at least 40% of the fob price.

As India is in any case supplying a substantial share of the imported inputs of Bangladesh's exported RMG exports to India. Moreover, backward integration in knitting already allows most Bangladesh knitted garment producers to easily satisfy this requirement. Therefore, the application of the same or similar origin rules in a bilateral Indian-Bangladesh FTA, or in SAFTA, would constrain Bangladesh exporters to some extent, but not seriously. Nevertheless, if Indian materials that would otherwise not be used, are used to satisfy the origin rules, by definition the Bangladesh exporters to India are disadvantaged relative to a situation without the rules of origin, In this regard, the Bangladesh ban on yarn imports from India by the land route (in force since 2002) obviously disadvantages Bangladesh RMG firms (especially knitwear firms, it seems) exporting to the rest of the world and actually exporting (or interested in exporting) to India.

In the preceding sections, we have tried to demonstrate that an FTA with India, with both countries maintaining their present tariff and other policies with respect to the rest of the world, would provide export opportunities in India for Bangladesh RMG products. Governments of India and Bangladesh agreed that India would grant duty free access to Bangladesh RMGs, but Bangladesh would for the time being not provide any preferences for RMG imports from India, or stagger duty elimination for a few years.

However, a number of cautionary points need to be made in this regard:

- RMG industry in both India and Bangladesh are highly competitive. Domestic prices of exported garments are probably close to or below c.i.f. import prices. Therefore, even with the advantages of tariff exempt access and proximity, Bangladesh garment exporters would have to mainly compete for market niches based on style, design, marketing, quality etc. For this they would need to work with Indian traders and distributors, and the Indian traders would have to find some clear advantage in sourcing from Bangladesh rather than Indian suppliers.
- A number of RMGs which Bangladesh exports to other countries are not subject to specific duties in India, but until FY 04 none were being exported to India. For most RMGs India's preferential *ad valorem* tariff for Bangladesh in 2003/04 was 20%, and after that it was reduced to 10% in FY 05 and FY 06 to 7.5%. Unless some Bangladesh exports have developed since FY 04, this suggests that even relatively low *ad valorem* tariffs are sufficient to deter exports of these products to India.
- Sri Lanka is a major RMG exporter and under ILFTA it has more generous RMG tariff preferences (mostly 75%) in India than Bangladesh's SAPTA preferences(mostly 50%, some 60%). In 2005/06 its preferential *ad valorem* tariff for RMG products was 3.75%. Despite this, its RMG exports to India are practically nil.
- Garment industry direct labour costs are much lower in Bangladesh than in India, but these differences are minor relative to typical garment selling prices in world markets, and in selling to India could easily be offset, or more than offset, by differences in other costs (especially fabric and yarn costs), quality, design, delivery times and other non-price factors.
- In Bangladesh garment exporters were to develop substantial exports of some RMGs to India, part of the new exports are likely to have been diverted from other export markets. Hence, the net increase in exports resulting from the preferential opening of the Indian market will be less than the increase in exports to India.

It may be noted that Bangladesh has signed on to the framework agreement for Bay of Bengal Initiatives for Multi-sectoral Technical and Economic Cooperation (BIMSTEC) Free Trade Area, whose constituent agreement for trade in goods is slated to take effect in June 2006. This brings into focus a middle-income country like Thailand as a potential market for RMG with zero-tariff access.

It is to be recommended that as a negotiating strategy, Bangladesh would be well advised to have a short negative list for SAFTA or FTA, as long as RMG is not on India's negative list. Penetration of the Indian RMG market via preferential arrangements remains a viable strategic option, as also are potential openings through BIMSTEC free trade area.

9.11 Compliance with Social and Labour Standards

As Bangladesh emerges as a major player in the global RMG export market, the pressure is mounting for compliances with social and labour standards. Failure to conform to international norms could undermine competitiveness. The European Union and the United States, which together account for more that 70 percent of Bangladesh's total export market, insist on strict compliance with social and labour-related standards, as well as ecological norms, as a precondition for doing business. In the face of international competition in the post-MFA era, Bangladeshi manufacturers must be able to respond to and harmonize their views with buyers in order to address the challenge.

Evidence suggests that hitherto inadequate attention has been given by the industry to the various aspects of social accountability. It would now be opportune for Bangladeshi firms to conform to SA8000 standards – the international standard for social accountability in the workplace. SA8000 provisions focus attention on the personal safety and health for all employees recognizing that contented workers are motivated to raise their productivity and work quality. Though designed to cover welfare and comfort of employees, SA8000 has now been adopted, with some variations, as a benchmark for sourcing decisions by buyers. The problem is that, unless adapted to country circumstances, SA8000 could become a ploy to protect high cost firms in developed country markets. Aspects covered by these standards include fair compensation, compliance with labour laws – e.g. minimum working age, work hours, good personnel practices, environmental protection, hygiene and sanitation, etc. They also relate to labour safeguards to ensure health and comfort of employees in the work place-e.g. work posture, temperature, humidity and air circulation, illumination, fire prevention and fire fighting etc.

It is advisable, therefore, that RMG firms recognize these requirements as necessary for the health and safety of employees and undertake that the standards set out in SA8000 are implemented and maintained. This is important not only from the point of view of enhancing competitiveness and sustaining repeat orders, but is also critical for keeping workers motivated to improve productivity and product quality.

Bangladesh Garments Manufacturers and Exporters Association (BGMEA), in cooperation with International Labour Organization (ILO), have been working towards meeting social compliance requirements in its member factories. Besides ILO, development partners, like UNDP, GTZ, and EU are working with manufacturing enterprises, civil society, buying houses, labour organizations and the Government to effectively raise the capacity of compliance services in Bangladesh. The Ministry of Commerce has taken the initiative to form a "National Forum on Social Compliance", and a "Compliance Monitoring Cell". All this argues well for the sector under the post-MFA regime. It is to be recommended that to remain competitive and win orders, RMG firms must conform to international standards of social compliance for their industry.

9.12 Government-Industry Partnership to Develop Forward Linkage:

Most assessments of the Bangladesh RMG industry find serious shortcomings with regard to its international market orientation – the ability to gear up its marketing campaign in response to changing demand. Long years of exclusive reliance on foreign buying houses or their agents have contributed to this outcome. The post-MFA trading regime demands savvy merchandising and marketing of products in order to penetrate and maintain market share in export markets. Focus on such forward linkages is a must. The following approaches highlight some of the key strategies for promoting forward market integration.

Product and market diversification: One of the major limitations to apparel export growth is the lack of diversification in products and markets. Besides the export concentration that has been discussed earlier, there is also a problem of product concentration – a small range of products (shirt, trousers, T-shirts, sweaters, jackets) make up 60% of RMG export. Vigorous marketing and promotional drives would be needed to break into markets for other RMG products that Bangladeshi producers are capable of producing completely. That brings up the critical role of R&D and market research to expand the product mix and public support in this area might be needed. A comprehensive research centre built on public-private partnership should be able to gather and disseminate information effectively to local manufacturers on the latest development in products and markets, including information on fabric developments, blends, colours, patterns, latest fashion trends and design forecasting, as well as providing customer service to foreign buyers purchasing from Bangladesh.

Image building and branding can achieve a high level of value addition. As part of image building, brand development can also enhance Bangladesh's reputation as a quality supplier of apparel. As branding is an expensive investment, incentives and opportunities should be provided to exporters, such as through a 'Brand Fund' and encouraging foreign collaboration to launch collective brand names through corporate marketing companies. Investment in skills, design and advertising will have to be made in order to make the yet unknown "Made in Bangladesh" label become known in the global marketplace. For this, an active promotion campaign will be required by the industry, Government and the Export Promotion Bureau (EPB). Local and international exhibitions should be held with aggressive efforts to attract foreign buyers. Bangladesh embassies abroad should appoint dynamic business oriented commercial officers whose main job will be to promote export products through direct contact with potential buyers. Without being pro-active, it is impossible to built direct relationships with buyers.

At home, an exporters' performance rating database could also be developed, based on factors such as product quality, timely delivery and financial performance. This facility should be set up in collaboration with an accredited international company so as to ensure objectively and credibly. Bangladesh has a limited number of joint venture RMG industries; these can be very effective in bringing in managerial and marketing expertise. Continuous efforts should be made by the Export Promotion Bureau and the Board of Investment to ensure a favourable investment climate to allow for more FDI and Joint ventures. The positive spillover effects of FDI have already been noted.

9.13 Specialized Units

The RMG sector constitutes a long value chain, ranging from spinning, dyeing, weaving, printing, stitching and knitting. Each of these processes involves independent units with specialized labour and machinery. Small and medium enterprises should be encouraged to set up these specialized units, with incentives such as provision of long-term financing at subsidized rates and allowing duty-free imports of the machinery required. This calls for supportive public policy.

9.14 Human Resources Development

Middle-level management is a bottleneck in the industry and there is a critical need for skill enhancement. Focus should be placed on ‘training of trainers’ to ensure continual quality training and skill development.

It is important to note that FDI, specialized units and HR development are all important topics by themselves. But the report does not elaborate on these topics as they would require very detailed treatment. It is recommended that Bangladesh RMG industry must gear up to meet the many shortcomings that create a distance between itself and its markets/customers. Building strong buyer-supplier relationships and focusing on image building (quality, skill, branding, etc.) are two areas most in need of attention.

CHAPTER X

SCOPE TO PROMOTE TRADE UNDER WTO SYSTEM
EXTERNAL CONSTRAINTS AND OPPORTUNITIES IN BANGLADESH

10.1 Introduction

Trade liberalization in Bangladesh has contributed significantly to the opening of the economy to the global market. The growth in the degree of openness of the economy implies that external factors such as foreign direct investment, the Uruguay Round Agreement, regional integration, and trade links with neighbours would have important implications for the performance of the Bangladesh economy. One important external influence in trade policy in developing countries is foreign direct investment, which has significant benefits in improving access to export markets, transferring technology and management skills, and increasing production efficiency and competition. Secondly, another pertinent issue is whether a developing country like Bangladesh would derive benefits from the Uruguay Round Agreement. Thirdly, hoping to reap the benefits of a greater outward orientation while retaining a considerable measure of protection against much of the world, many developing countries have participated in regional integration schemes. Fourthly, trade links with neighbours also have strong influence on the trade policy of developing countries. This chapter examines the roles of foreign direct investment in Bangladesh, the impact of the World Trade Organization on the Bangladesh economy, regional trade cooperation in South Asia and bilateral trade issues with India. This discussion is mainly based on reviewing the available literature on these issues.

10.2 Foreign Direct Investment (FDI) in Bangladesh

Foreign direct investment (FDI) is useful to overcome structural constraints in a country.[46] FDI is shown to be more growth-enhancing in countries that pursue export promotion (EP) than in that promoting import substitution (IS) (Bhagwati, 1978). FDI contributes to improving international competitiveness and economic growth in developing countries (WTO, 1996; Moran, 1998; De Rosa, 1998). While pointing to the benefits of FDI in terms of physical capital formation, technology transfer and higher competitive efficiency,

[46] For a selective survey of FDI and growth in developing countries, see de Mello (1997)

the downside risks associated with the rising debt service payments must not be lost sight of (World Bank,1999c).

Two important factors which have motivated Bangladesh to attract more FDI are: (i) declining trend of foreign assistance and (ii) saving-investment gap. Foreign investors seek out the place of investment where there is availability of infrastructure facilities and supply line to the market. Transport and communication links, port services, banking facilities, legal framework, export-import regulations, labour laws, energy supply and availability of productive labour are some of the issues of importance to investors. The multinationals do not simply bring in capital, new technology, and innovative management style, but these days they also contribute to export promotion and in-situ research and development (Muhith,1999).

Foreign private capital inflows into Bangladesh have taken three forms: Foreign Direct Investment, Portfolio Investment, and Foreign Currency Loans (suppliers' credit[47]). Since FDI is making up about 85-90 per cent of total private capital inflows (World Bank, 1999c), we are concentrating on FDI in Bangladesh.

FDI is an emerging phenomenon in Bangladesh. Since 1986 special efforts are being made to secure FDI; privatization is being emphasized, liberal trade policy is being implemented and government regulations are being relaxed. The policy framework for foreign investment in Bangladesh is based on Foreign Private Investment (promotion and protection) Act 1980, which provides for (i) non-discriminatory treatment between foreign and local investment, (ii) protection of foreign and local investment, and (iii) ensured repatriation of proceeds from sale of shares and profit.

In Bangladesh investors are allowed to undertake investment in all but four areas, which have been kept on the reserved list. Foreign entrepreneurs can set up projects either with 100 per cent ownership or jointly with local entrepreneurs. They are allowed to repatriate capital equivalent to investment, dividends, royalties, capital gains, and salaries (up to 50 per cent of net salaries). No approval, permission, or No Objection Certificate (NOC) is required for establishing industry with own funds in free sectors. One hundred percent

[47] For an account of Suppliers' Credit in Bangladesh, see World Bank (2006)

foreign-owned as well as joint-venture industrial units located in export processing zones[48] (EPZs) may freely borrow funds in foreign currency from abroad without prior approval of the Bangladesh Bank. The industries in EPZs enjoy several fiscal incentives in the form of tax holiday, exemption of income and dividend taxes, duty-free import of capital and other goods, and duty-free export of goods produced in the zones.

Despite significant policy incentives provided over the last few years, Bangladesh has failed to attract a substantial amount of FDI. Compares to her South Asian neighbours, the inflow of FDI into Bangladesh is scanty. During the period 1996-99, the average inflow of FDI into Bangladesh was to the tune of US$ 0.15 billion as against US$ 2.70 billion in India and US$ 0.67 billion in Pakistan (UNCTAD, 2000). **Table 10.1** presents data showing trends in FDI inflows to Bangladesh, which have traditionally been low. It is evident from the Table that energy sector (gas ad power) dominated the inflow of FDI into Bangladesh during the period 1994-98.

Table 10.1: Profile of FDI Inflows into Bangladesh, 1994-98 (in million US$)

Sectors	**1994-95**	**1995-96**	**1996-97**	**1997-98**
1. Gas	14	40	170	217
2. Power	0	0	0	60
3. Telecom	0	4	31	26
4. FDI in EPZ	31	26	46	59
5. Other FDI[49]	38	171	50	25
Total	**83**	**241**	**297**	**387**

Source: World Bank (1999c)

The bulk of FDI and private debt appears to have financed imports of capital equipment and machinery in power, gas and telecom sector. The high import intensity of FDI inflows and subsequent profit repatriation and interest payments imply a worsening current account deficit associated with FDI. As FDI in Bangladesh (with the exception of those in EPZs) is characterized by its inward-orientation, its direct impact on exports and in generating incremental foreign exchange is difficult to gauge. Since higher production in manufacturing sector in Bangladesh, including the export-oriented RMG sector is partly constrained by energy shortage, removal of energy constraint through FDI in gas development and power generation is likely to contribute to higher exports and increased foreign exchange earnings.

[48] EPZs are enclave-type arrangements.
[49] Other FDI includes 5a. ports (container terminal), 5b. Biman i.e. aviation (foreign partnership), 5c. cement. 5d. textile (including RMG) and 5e. other (non-EPZ manufacturing and services)

Focusing on FDI during the 1989-93 period, one study observes, "Bangladesh's effort, by offering various incentives, at attracting FDI has been weak. There has been an exodus of foreign companies from Bangladesh over the past several years. The reasons mentioned include poor law and order situation, political and policy uncertainty, disaster proneness of the country, underdeveloped infrastructure, bureaucratic and labour problems and stagnancy of the economy (Ahmad, 1994;17). This is corroborated by Reza and Rashid (1997). There has been some withdrawal of existing foreign investment. For example, the pharmaceutical firm, ICI, has totally wound up its operations in Bangladesh, as has Philips. A UNCTAD (1996) study identifies a few factors, which are not conducive to FDI inflows in LDCs. These include poor telecommunications and transportation facilities, a generally unskilled labour force, non-transparent legal and regulatory framework, high levels of external debt, macroeconomic instability and small domestic markets. Besides, a history of political instability also discourages FDI inflows. A recent World Bank study cautions about the downside risks associated with FDI- "This growing repayment obligation presents prospects of net transfers in the future and poses major challenges requiring the country to search for new avenues of earning (or saving) additional foreign exchange" (World Bank, 1999c: 19). Efforts should be made to address these issues in order to attract more FDI inflows into Bangladesh. For attracting more FDI, the regulatory culture should be moderate, rule of law must be established, good financial and physical infrastructure must be built and a skilled labour force should be created. Bangladesh may attract FDI in information technology (IT) and telecommunications sector so as to overcome many of the disadvantages of distance. Moreover, the economy's debt-servicing capacity needs to be enhanced for making private capital flows sustainable. This apart, the FDI reporting system should be improved for effective monitoring of FDI flows.

10.3 Opportunities under WTO System

10.3.1 Impact of World Trade Organization on Bangladesh

The ratification of the final Act of the Uruguay Round Agreement in April 1994 marked the beginning of a multilateral trading system based on more transparent rules and discipline. World Trade Organization (WTO), which was established on January 1995 has been mandated to implement GATT rules to regulate the world trading system. In this section we will discuss the impact of WTO on the textile and clothing sector of the Bangladesh economy as it contributes the significant share of export earnings of the country and possibility of enhancing trade under WTO system.

10.3.2 Impact on Textile and Clothing

The WTO Agreement on Textile and Clothing (ATC) succeeds the Multi-Fibre Arrangement (MFA) with the ultimate objective of putting in place a market driven global trading regime in textile and clothing. The ATC calls for the gradual elimination of restrictive trade practices, such as the MFA and the completed the integration of the textile and clothing sector into GATT 1994 by January 1, 2005. The integration process took place based on three principal elements: (1) product integration. (2) quota integration and (3) tariff cuts.

The ATC would lead to gradual elimination of restrictions on imports from countries with stronger industrial bases whose products compete with those of Bangladesh (e.g. China, Indonesia, India, Pakistan, Vietnam, Cambodia, Philippines, Vietnam, Thailand, Lao PDR and Sri Lanka). Though Bangladesh has the cost advantages in some areas of the garment items like jeans and T-shirts, more established exporters of Asian and Latin American countries having their own backward linkage industries might cut into the market share, which Bangladesh has been traditionally enjoying. Moreover, competition from other developing countries for attracting textile and garments related FDI might have kept Bangladesh behind because of her poor infrastructural and institutional facilities do not meet FDI requirements. Bangladesh needs to attract FDI to set up backward linkage industries and Public-Private Partnership initiative can also play an important role to set up necessary infrastructure to enhance the competitive strength of Bangladesh.

For South Asia, the most significant gains would result from the removal of the Multi-Fibre Arrangement (MFA). Estimates were that South Asia's textile output would increase 17 percent, and textile exports 26 percent as a result of the phase out of the MFA. Output and exports of readymade garments would increase an estimated 91 percent and 254 percent respectively (Hertel et al., 1995). Studies show that the coverage of non-tariff barriers (NTBs) of OECD countries is expected to drop most sharply for exports from Bangladesh and Sri Lanka, thus giving them a major advantage in market access.

A study on the impact of GATT on Bangladesh's textile sector (Rashid, 1994) finds that the dismantling of the MFA was expected to lead to heightened competition from such countries as Pakistan, India, China, and Thailand, countries from which Bangladesh imports most of its fabric requirements. The supply of fabrics from these countries may be drastically reduced as these countries no longer constrained by quota limitations, try to expand their own RMG exports using locally sourced fabrics. In view of these circumstances, the study concluded, backward integration in the textile sector appears to be a precondition for continued export of RMG from Bangladesh.

In reality, under the ATC preferential treatment promised to LDCs including Bangladesh in terms of technical assistance, safeguard clauses, Special and Differential (S&D) treatment, derogation commitments, best endeavour provisions, effort and flexibility clauses have remained largely unrealized. If this experience is to be treated as a *learning curve* for LDCs, then a cautious approach by LDCs can be the only judicious strategy in many future negotiations in the WTO (Rahman, Bhattacharya and Titumir, 2000).

Another cause of concern is the USA Trade and Development Act 2000, which provides duty-free and quota-free access to 48 countries of Africa and 24 countries of Caribbean Basin for exporting textile, apparel and other products to the USA market, provided they meet certain eligibility criteria.[50] The Act calls for a careful scrutiny as it has important implications for Bangladesh's apparel exports.

[50] For the salient features of the USA Trade and Development Act 2000 abd a response from Bangladesh perspective, see Bhattacharia and Rahman (2000)

10.4 Regional Trade Cooperation in South Asia

The eight members of SAARC[51] account for 20 percent of the world population but only 2 percent of the world GDP (ESCAP, 1997). Their collective share of world trade is 1 percent and intra-regional trade accounts for only 4 percent of the total trade (Pigato *et al.*, 1997). Thus trade amongst the SAARC member-countries has traditionally been insignificant.

Table 10.2: Intra- SAARC Trade in Asian and Global Trade of SAARC Countries

SAARC Trade	1970	1980	1990	1991	1992	1993	1994
Value of intra-SAARC trade (million US$)	143	639	861	946	1222	1220	1417
Intra-SAARC trade as % of SAARC exports to developing Asia	27.5	18.4	17.4	20.2	22.5	19.9	20.5
Intra- SAARC trade as % of total world exports of SAARC	4.6	5.0	3.2	3.3	4.0	3.7	3.7

Source: Hossain, Rahman and Rahman, 1997.

As Table 10.2 shows, in 1994 intra-SAARC trade was only 3.7 per cent of their total global trade, which is less than it was in the 1980s when it was 5 per cent. In exports of a number of commodities, SAARC member-countries compete intensely with one another in the international market. Bangladesh and India compete in the markets of U.S.A. and EU in exporting such tradables as jute and jute goods, while all the major SAARC countries compete with each other in the exports of RMG in the markets of industrial countries. In the case of textile exports there is a tough competition between India and Pakistan whereas in exports of leather and frozen fish Pakistan, Bangladesh and India compete with each other. India and Sri Lanka are major competitors in the markets for processed gems, diamond and jewellery. The competition among most of the SAARC countries for textile and apparel markets especially in the U.S.A. is expected to accentuate with the phasing out of the MFA.

Among the eight SAARC member countries, only India and Pakistan enjoy a positive intra-regional balance of trade. Bangladesh's major trading partners within South Asia remain India and Pakistan which together account for more than 95 percent of its imports from SAARC countries and 75 per cent of its exports to SAARC countries.

[51] The eight member-countries of SAARC are Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

The issue of regional cooperation in the field of trade has been one of the major concerns of the member countries of SAARC. Obviously, economic and trade reforms implemented by individual SAARC member countries over the last decade have contributed to creating a conducive environment for a closer cooperation in the field of trade and investment. This shared commitment to regional trade promotion has been now institutionalized following the signing of the agreement by all the member countries of SAARC to put in place a South Asian Preferential Trading Agreement (SAPTA), in April 1993. Coming into being, the principal objective of forming the SAPTA was to liberalize trade in the South Asian region through a step by step approach in such a manner that countries in the region share the benefits of trade expansion equitably. All the members of SAARC ratified the agreement by December 1995. The SAPTA trade cooperation is to be phased in through: (i) reduction of tariff rates on an item-By-item basis, (ii) reduction of tariffs on a sector-By-sector basis, and (iii) establishment of a South Asian Free Trade Area (SAFTA) not later than 2005 (REZA, 1996). The SAPTA includes all products: manufactures, and commodities in their raw, semi-processed and processed forms. It is to be noted that SAFTA has been established in 2006.

The SAFTA, inter alia, consists of arrangements relating to: (a) tariffs, (b) para-tariffs,[52] (c) non-tariff measures and (d) direct trade measures. It also gives special and more favourable treatment exclusively to the LDCs in SAARC, if they satisfy the rules of origin: (a) duty-free access, exclusive tariff preferences of deeper tariff preference for export products; (b) the removal of non-tariff barriers; and (c) the removal, where appropriate, of para-tariff barriers.

Under the SAPTA, member countries have already exchanged " Offer Lists" and "Request Lists" indicating preferences for tariff reduction, and eventually agreeing to reduce tariff rates ranging between 10 per cent to 100 per cent on 226 commodities traded among the SAARC countries.[53] Table 10.3 gives a summary of the national schemes of concessions granted by the SAARC countries under the SAPTA.

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[52] "Para-tariffs" means border charges and fees, other than tariffs, on foreign trade transactions with a tariff-taxes and charges which are levied in the same manner like domestic products.

[53] The Second Round of south Asian Preferential Trade Negotiations held on 29 November 1996 further listed over 1500 items for 10-15 per cent tariff concessions (Reza,1996).

Table 10.3: Consolidated National Schedule of concessions granted by SAARC Countries under the SAPTA

Country	No. Of product at 8-digit level		Major product types		Tariff range	Extent of concessions for	
	Non-LDCs	LDCs	Non-LDCs	LDCs		Non-LDCs	LDCs
Bangladesh	11	1	Insecticides, surgical instrument, dental cement and fillings, grapes, limestone	Quartzite	7.5%-60%	10%	10%
Bhutan	4	7	Surgical and sports goods, food items, precious, semi-precious stones, tyres, gloves	Macaroni, noodles, bread	10%-50%	15%	10%-13%
India	44	62	Tyres, cotton yarn, flour coverings, household articles	Tableware, kitchenware, clothing, accessories, gloves, mittens, leather articles	25%-50%	10%-50%	50%100 %
Maldives	17	0	Leather, leather goods, raw jute, carpets, perfumes, furniture		15%-25%	7.5%	
Nepal	10	4	Sports goods, dry fruits, canned fish	Gypsum, coal, furniture	%-30%	7.5%-10%	7.5%-10%
Pakistan	20	15	Unalloyed aluminum, essential oils, rubber, pepper	Raw and processed jute (not spun), wet blue leather	10%-70%	10%15%	10%-15%
Sri Lanka	20	11	Jute yarn/carpets, aluminum, motor cycles	Plywood, processed fruits, noodles	10%-35%	10%-20%	10%-20%

Source; Hossain, Rahman and Rahman, 1997

Out of 226 commodities covered by preferential tariff concessions, 126 are on offer to non-LDCs and 100 to LDCs. Table 10.3 shows that the single largest number of concessions is offered by India (106), although in terms of exchange of trade preferences, Sri Lanka alone accounts for more than 50 per cent of the concessions offered. India offers only 16.8 per cent of the total exchange of preferences amongst the SAARC countries. As far as Bangladesh is concerned, her offers accounted for less tan 4 per cent of the total concessions on offer. In contrast, Bangladesh has received a substantial share of the total concessions under the agreement. While most of Sri Lanka's concessions would be favouring India and Maldives, Bangladesh is the major recipient of concessions offered by both India (56 per cent of the country total) and Pakistan (51 per cent of the country total). Table 10.4 gives the value of concessions offered and received by the contracting countries under the SAPTA.

Table: 10.4: Value of Concessions offered and Received by the Contracting Countries under the SAPTA (in thousand US $)

Offered/Received	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	South Asia
Bangladesh	-	0	6778	0	0	4487	17.48	11282.4
Bhutan	0	-	11.6	0	0	0	0	41.6
India	2328	0	-	83	11289	1248	25080	40064
Maldives	0	0	12.2	-	0	0	12081	12093. 2
Nepal	0	0	1885	0	-	0	7.8	1892.8
Pakistan	21.3	0	2435	0	0	-	49.1	2505.4
Sri Lanka	429	0	992.9	66	135.4	2982	-	4605.3
South Asia	2778.3	0	12144	149	11424	8753	37235	72483.3

Source: Hossain, Rahman and Rahman, 1997.

The degree of interest in closer economic integration does not seem to be the same for all the SAARC countries. Although the leaders of different SAARC member states have put the issue of SAPTA on the political agenda of their respective countries, so far the pace of progress in realizing the various potential avenues of regional cooperation has been very low. Despite many skepticism and pessimism, finally the South Asian Free Trade Area (SAFTA) was formed in 2006. The results of a study by Srinivash and Canonero (1993), based on an extension version of a gravity model, for example, show that for the larger economies like India and Pakistan, the principal gains seems to come from preferential arrangements with the mega blocks, e.g., NAFTA and EU. Contrarily, regional integration is South Asia will lead to greater gains in the value of trade for smaller countries like Bangladesh and Nepal.

Hossain, Rahman and Rahman (1997) estimated a gravity model to identify the impact of regional trading blocks on intra-regional trade and found that the trade effect is positive but the magnitude depends on the degree of integration among the member countries. Using an increasing-cost model, M.M. Hossain and Vousden (1996) examined the welfare implications of the proposed discriminatory trading area in South Asia comprising Bangladesh, India, Pakistan and Sri Lanka. Their results show gains for the region as a whole. However, the small partners (Bangladesh and Sri Lanka) suffer, while the big partners (India and Pakistan) gain from the formation of a hypothetical customs union.

de Mele and Rodrik (1993) found that most of the preconditions needed to enhance the probability of a successful free trade arrangement were not present in South Asia. These preconditions include high-prearrangement tariffs, high level of trade before any arrangement, the existence of complementary rather than competitive trade and differences in economic structure based on competitiveness. They concluded that South Asia would be better off liberalizing unilaterally and trying to tie up with established groups such as NAFTA and EU. Pigato *et al.* (1997) presented two sets of simulation results- one under regional trade liberalization where significant benefits accrue to both India and the rest of South Asia and the other under unilateral trade liberalization. This is because the rest of South Asia gains free access to the highly protected Indian market, and these results in a significant improvement in their terms of trade. But India's terms of trade gains are low, because the level of protection in the rest of South Asia is lower than in that in India. The authors, however, pointed out that the two scenarios are based on the 1992 level of trade protection, which was much higher than now. It is, therefore, conceivable that the gains from regional trade liberalization currently be lower than that was anticipated in the simulation. Bangladesh's very limited economic engagement in the region suggests that SAPTA/SAFTA is likely to result in more trade diversion than trade creation (Mahmood, 1998). This highlights the fact that Bangladesh is likely to benefit more from unilateral trade liberalization than a regionally based preferential trading arrangement. But one study shows that liberalization of trade in SAARC countries offers significant gains for all the economies in the region (Hossain, 1998). This study recommends for making efforts to liberalize border trade and strengthen bilateral trade relations through separate sets of trade concessions in the general framework of SAFTA.

10.5 Bangladesh's Bilateral Trade Relations with India

The issue of Bangladesh's bilateral trade relation with India is particularly important for a number of reasons. First, Bangladesh shares a long and porous border with India. Secondly, the two countries' exports of Jute, lather goods and tea compete directly in World market. Thirdly, illegal imports from India ranging from textiles to eggs are affecting Bangladesh producers. The price differentials, caused by exchange rate adjustments favourable to India, produce a high incentive to smuggling (World Bank, 1993a). The cost of legally crossing the tariff and non-tariff barriers is greater than the risk of legally crossing the administrative obstacles to free trade (Khan, 1995). Table 10.5 shows large and growing trade deficits with India. The average trade deficit in fact went up from 0.47 percent of Bangladesh's GDP during the period 1986-91 to 2.25 percent during 1992-97.

Table 10.5: Bangladesh's Trade Deficit with India, 1973-1997 (Million US $)

Year	Exports	Imports	Trade Deficits	Trade Deficits (% of Bangladesh's)
1973	23.3	114.8	-91.5	1.57
1974	0.4	82	-81.6	0.93
1975	5.3	82.2	-76.9	0.74
1976	7.1	62.7	-55.6	0.79
1977	0.6	48.9	-48.3	0.70
1978	2.3	43	-40.7	0.42
1979	12.1	40	-27.9	0.25
1980	8	55.6	-47.6	0.37
1981	20.2	64	-43.8	0.34
1982	20.3	43.3	-23	0.19
1983	6.9	37.9	-31	0.26
1984	28.3	60.1	-31.8	0.23
1985	29.6	64.9	-35.3	0.24
1986	7.7	57.2	-49.5	0.32
1987	11	33	-22	0.13
1988	9	90	-81	0.43
1989	11	121	-110	0.54
1990	22	170	-148	0.69
1991	23	189	-166	0.73
1992	4	284	-280	1.20
1993	13	380	-367	1.53
1994	24	467	-443	1.73
1995	36	994	-958	3.30
1996	20	1138	-1118	3.59
1997	30	724	-694	2.17
Period Averages (%)				
1973-85	12.65	61.49	-48.85	0.54
1986-91	13.95	110.03	-96.08	0.47
1992-97	21.17	664.50	-643.33	2.25

Source: Author's calculation based on IMF, Direction of Trade Statistics Yearbook and IFS (various issues).

There are conflicting views as to whether Bangladesh's large and growing trade deficits with India are a foregone conclusion under a free trade regime. At the one end some authors believe that such trade deficits are natural under a free trade environment given India's high stage of development or technological maturity (Sobhan, 1990). On the other hand, Hossain Rashid (1998) by estimating Bangladesh and India's revealed comparative advantage (RCA) for SITC 1-2 digit industries during the period 1975-1993 show that these countries' revealed comparative advantages and disadvantages are in similar types of products. However, their RCA measure for SITC 1-2 digit industries may not reveal fully the true nature of comparative advantage. Moreover, the period 1975-1993 covered by the study does not reflect recent trends.

In view of trade liberalization in both these countries a decline in the volume of illegal trade could be expected. But this did not happen in reality. Large-scale illegal imports from India are a drain on government's revenue and foreign exchange reserves, a promoter of black economy, and a destroyer of small and medium enterprises in both export-oriented and import-competing industries in Bangladesh. Table 10.6 reports data for the composition of illegal trade between Bangladesh and India.

Table 10.6: Main Items in Illegal Cross-border Trade Between Bangladesh and India

Commodity	Value (US$ Million)	Share of exports/imports (%)	Trade restriction
Imports			
Livestock, poultry, fish ad related products	252.0	40.0	
Live animals (cattle)	216.0	34.2	Restricted export (India), increased tariff (Bangladesh)
Agricultural products	78.0	12.4	
Sugar	35.0	5.6	Banned
Processed food and tobacco	114.2	18.1	
Textiles	76.2	12.1	Banned
Saris (cotton)	50.0	7.9	Banned
Other industrial manufactures	26.9	4.3	
Bicycles and parts	13.9	2.2	High tariff + VAT
Other consumer goods	83.6	13.2	
Electronics	43.1	6.8	
Total Imports	631.0	100.0	
Exports			
Copper, brass and other metals	61.7	58.0	
Fish	35.1	33.0	
Synthetic textiles	4.6	4.3	Lower import duty in Bangladesh
Electronics, spares	5.1	4.8	
Total Exports	106.0	100.0	
Total Illegal Trade	737.0		

Note: This Table is based on NCAER-BIDS field survey conducted in 1994.
Source: World Bank (1996a).

Table 10.6 shows that livestock, poultry, fish and related products, and other agricultural products constituted about 52 per cent of Bangladesh's illegal imports from India. On the other band, copper, brass, and other metals alone constituted 58 per cent of Bangladesh's illegal exports to India. Copper, bras, electronic goods (including those assembled in Bangladesh). Cigarettes, wine, fertilizer, gold, raw jute, and imported cement were some other illegal exports to India (Ghafur, 1990). Thus the bulk of Bangladesh's imports (Legal and illegal) from India are consumer goods and materials for consumer goods.

Its exports (legal and Illegal) to India Include those products which have some scarcity premiums, such as chemical fertilizer, raw jute, fresh fish, imported electronic goods, gold, copper, brass, and other metals.

The sizable unofficial border trade with India has been a subject of a number of studies (Ghafur, 1990; Ghafur, Islam and Faiz, 1990 and 1991; Alam and Cookson, 1995; Bakht, 1996 Rahman and Razzaque, 1998). A recent study by Rahman and Razzaque (1998) estimates the annual value of unrecorded commodity imports through the five surveyed thanas at US$185 million, suggesting that the value for the whole border could be at least as large as official trade level or eve twice that amount.

Recent findings also show a general similarity with the earlier findings (and a few changes) in the composition of illegal imports. Cattle were and remain the largest category. Other important imports include: food items, textile products, spare parts of trucks, bicycles and parts, timber, phensidyle, ceiling and table fns; and toothpaste. On the export side, gold appears to be the single largest commodity, accounting for one-third of the five centre’s exports. Just four other groups made up most of the rest, including electronic goods, metals, hilsha fish, and high-count yarn (world Bank, 1996b).

10.5.2 Factors Affecting Bilateral Trade Relations

10.5.2.1 Appreciation of Bangladesh’s Real Exchange Rate with India

While Bangladesh’s multilateral real exchange rate has show a tendency to depreciate interspersed with periodic appreciation, its bilateral real exchange rate with India (as well as Pakistan) shows signs of appreciation (Hossain, Rahman and Rahman, 1997). The bilateral real exchange rate that has been appreciating since 1986 and more so in recent years thus provides a basis for the growing trade imbalance. Given that and appreciation of the Bangladesh’s taka against India’s rupee has created and maintained an excess demand for the Indian products, the volume of illegal import has increases. The Bangladesh taka has dramatically appreciated vis-à-vis the Indian rupee, by as much as 43 per cent since 1986. It is not at all surprising that Bangladesh’s aggregate trade deficit with India has explodes. The dramatic appreciation of the taka vis-à-vis the Indian rupee due to the aggressive exchange rate adjustment that India has adopted in the period of globalization.

Table 10.7: Index of Real Exchange Rate between Bangladesh Taka and Indian rupee (1990=100)

Year	Index
1986	78.67
1987	79.94
1988	83.70
1989	99.38
1990	100.00
1991	114.70
1992	114.61
1993	124.76
1994	118.76
1995	117.57
1996	116.73
1997	112.27

Note: The real exchange rate between Bangladesh taka and Indian rupee (REX IB) is calculated from the exchange rate data of IMF involving the US dollar in the following way:
(i) $REX_{IB}=(EX_{IB}*CPI_B/CPI_I)$, $I \neq B$
Where EX_{IB} stands for average nominal exchange rates between India and Bangladesh; and CPI_B and CPI_I stand for consumer price indexes of Bangladesh and India respectively.
(ii) The index of real bilateral exchange rates (IREXIB) is constructed by selecting 1990 as the base year: $IREX_{IB}=(REX^{t}_{IB}/REX^{90}_{IB})*100$
Source: IMF, IFS (various issues).

The implication of the appreciation of the Bangladesh taka *vis-à-vis* the Indian rupee is simple. This makes Bangladesh exports to India expensive but imports from India cheaper. Being costlier, Bangladesh exports cannot compete with Indian goods but Indian goods being cheaper find an easy market in Bangladesh.

10.5.2.2 Administrative Problems

Despite progressive liberalization the trade regime in Bangladesh remains protective enough to provide incentives for smuggling. Though import procedures have been gradually simplified, an importer still has to go through a lot of administrative hassles, which raises the cost of doing business (M.I. Hossain, 1997). This makes the alternative of smuggling easy, convenient and profitable. Through prior arrangements of profit sharing with the law enforcing agencies, smuggling is rendered into a routine activity (Bakht, 1996).

10.5.2.3 Inadequate Access to the Indian Market

Because of the Indian government's pricing policy and restriction of exports, prices of certain commodities are lower in the Indian market compared to their international prices. The relative price differential makes illegal import of these commodities to Bangladesh profitable (Bakht, 1996). Because of tariff and non-tariff barriers, there is inadequate access to the Indian market of many items of export interest to Bangladesh. India's trade regime continues to be highly protected. Table 10.9 presents a list of India's non-tariff barriers that have been prohibitive in so far as Bangladesh's exports to India are concerned. Some of these non-tariff barriers are policy-induced and other is institutional.

Table 10.9: Non-Tariff Barriers in India

Type of Non-Tariff Barriers	Sectors Involved
1. Imports of commodities which are permitted only under restrictive license or in accordance with a public notice.	Most consumer, intermediate, and capital goods
2. Canalized imports permitted only through state trading agencies.	Crude oil and petroleum products, iron and steel, nonferrous metals, fertilizers, edible oil, cereals, cotton, natural rubber, newsprint, cement, sugar, scrap metals, specified chemicals, electronic products, and drugs.
3. Imports permitted only against a license on the recommendation of various concerned departments.	For example, frozen semen allowed only under permission of Department of Agriculture.
4. Imports which are not allowed except in accordance with a public notice notifying permission.	Applicable in case of some non-consumer commodities (for example, fish meal).
5. Actual user policy that disallows imports for resale by intermediaries.	Almost all types of products which have some scarcity premiums.
6. Indigenous availability criterion which requires a certificate that a product of satisfactory specifications and quality cannot be supplied in a reasonable time by an Indian firm.	Almost all types of products, especially restrictive for consumer goods.
7. Phased manufacturing programmes in which importing firms agree to progressively replace imported materials, parts or components with materials, parts and components produced in –house or by other Indian firms.	Most raw materials and capital goods.
8. Restrictions on the use of foreign exchange by firms to pay royalties and license fees.	Mainly capital goods and technology products.
9. Imports of inputs to export-oriented units against a license or in accordance with a public notice which is issued favouring such imports.	For example, crude granite which is only applicable for export purposes.
10. Government purchase preferences given to domestic firms.	All types of products used by the central government, state governments and state enterprises.
11. prohibited.	Some particular commodities and drugs.

Source: Hossain and Rashid, 1998

10.5.2.4 Other Factors

Some of the export items notably RMG and knitwear are heavily dependent on imported inputs. With rising exports, demand for imported inputs grows. Further, growing incomes of people engaged in the expanding sectors of the economy lead to greater demand for consumption goods. Mujeri and Alauddin (1991) estimate the direct and indirect import intensity of consumption in Bangladesh to be 68-70 percent. Increase in income is thus translated into a large increase in the demand for imports. The growing demand for all types of goods-consumption goods, intermediate goods and capital goods is increasingly directed towards India for the factors mentioned above as well as its geographical proximity to India, which reduces “the transaction costs” of business travel and transport costs of moving goods between countries. Thus both policies induced factors and non-policy factors lie at the heat of the growing trade imbalance.

10.6 Summary and Conclusions

Bangladesh should make concerted efforts to attract FDI. At present FDI is coming mostly into the energy sector of the country. The Uruguay round Agreement offers opportunities as well as challenges for a developing country like Bangladesh. On the one hand, it provides an opportunity to increase exports by gaining more access to the markets of industrial countries; on the other hand, it also raises concerns about the intense competition among developing countries themselves.

Two important provisions under the GATT Uruguay Round Accord with major implications for Bangladesh exports are: (i) the phasing out of the MFA and (ii) the phasing out of GSP. The phasing out of the MFA provides significant opportunities as well as great challenges for Bangladesh. Reduction of tariff and quotas imposed by importing countries would provide a free trade environment in the textiles and garments trade and led to a significant increase in world trade resulting in increased benefits to exporting countries like Bangladesh. However, phasing out of the protected market provided by MFA by January 1, 2005 exposed Bangladesh to a much more competitive export regime. It remains to be seen what are the full implications of the Uruguay Round would be. A more liberal trade policy regime over the next decade is likely to present opportunities for greater market access to Europe and North America, but at the same time competition may be intensified as more textile producers would seek to take advantage of the market opportunities. Bangladesh may use the forum of the World Trade Organization for its integration with the global economy.

The SAARC countries need to go a long way to convert the SAFTA into an effective vehicle of regional cooperation and integration. The envisaged Free Trade Area in the SAARC in expected to pose formidable challenges for Bangladesh's export sector.

The smuggling of a portion of Bangladesh's imported goods across the border is likely to tell upon the effectiveness of trade liberalization policies. A liberalized policy with very limited control over movements of goods across borders would have severe implications for the demand for imported goods in general, and the composition of such goods in particular. The removal of India's non-tariff barriers to Bangladesh's exports through the SAARC is essential and if necessary, the issue should be raised before the World Trade Organization. A practical solution to large trade deficits with India should rely primarily on eliminating economic incentives for the imbalance. This can be effectively done if Bangladesh's taka is devalued to the extent that it neutralizes India's advantage against Bangladesh's products. Unlike tariff policy or export promotion policy, devaluation favours production of tradable goods as a whole at the expense of non-tradable goods. Hence high priority needs to be placed on a flexible exchange rate policy (World Bank, 1992b). The government should follow a flexible exchange rate policy in accordance with either a real targets approach or a nominal anchor approach (Corden, 1991).

CHAPTER XI

CONCLUSION AND SUGGESTION

In this concluding chapter we summarize the major findings of the study looking at the emerging constraints and challenges, and draw lessons for the way forward. There are some encouraging signs, which Bangladesh should seize on and try to make work to her advantage. Bangladesh is one of few developing countries that are expecting to attain a six percent plus GDP growth rate in 2008-09 Fiscal Year. Notwithstanding the measures taken by China to stimulate her export sector, leading buyers are exploring the possibility of shifting orders to Bangladesh because of the relatively low prices that Bangladeshi exporters are able to offer. As evidence suggests, Bangladesh has emerged as the foremost exporter of cotton trousers in the US market, with a market share of about 14 percent for this category. On the other hand, Bangladesh's export of cotton shirts to USA has been on the decline for some time now. Strong backward linkage in denim in case of the former, and dependence on imported fabrics in case of the latter, is possible reasons for such diverse growth performance. This reinforces the arguments favouring strategic support for Bangladesh's backward linkage textile sector.

Major buyer from Japan, a market worth about $22.6 billion of imported apparels out of which Bangladesh accounts for only $29.6 million (about 0.13 percent). This market has shown renewed interest to source from Bangladesh by diverting imports from other countries, such as China. The interest recently shown by a major Japanese buyer, Uniqlo (with imports worth $2 billion globally), to produce $600 million worth of apparels from Bangladesh is to be noted in this context. The adverse affects of current (2008-09) global recession, pressure to appreciate Yuan (appreciation of 5.2 percent over the last one year), wage rate that are about 2-3 times higher than in Bangladesh (though productivity is higher in China), makes Bangladesh destination for major buyers of apparels in spite of China's dominant presence in the market.

Only Vietnam's performance (16.9 percent growth during July-November 2008) is comparable to Bangladesh's record (15.7 percent) in the US market. All major competitors have either seen negative growth (Cambodia-2.9 percent, India-6.1 percent, Sri Lanka-1.1 percent) or low growth (China-3.6 percent). Alongside China is accounting for 33.1 percent of market share, which is by far the highest. Bangladesh (in fifth position with current share of 4.6 percent compared to Vietnam occupying second position with a share of 7.1 percent) should strive to secure the second position in terms of market share in USA. Indeed, Bangladesh's strategy in this time of global recession and falling global apparel demand should be to go for a higher share in the shrinking pie by making best use of the emerging opportunities. Government should consult with the private sector and exporters to review the current global situation and prospects of the RMG sector in short and long term in a continuous basis and should also take appropriate measures for speedy decision making. To take advantages of the emerging opportunities, Bangladesh would need to devise appropriate policies to create adequate incentives to encourage domestic entrepreneurs and attract foreign investors.

Policy makers may consider the idea of creating an export-stimulus fund to support entrepreneurs and export businesses. Such funds could be used to provide credit at lower rates, encourage acquisition and adoption of new technologies, and to promote R&D and process and product diversification at enterprise level. Such a fund could also be used to support entrepreneurs who are interested in setting up common services such as affluent treatment plants, skill up-gradation and dying facilities in the industrial clusters that are growing up around Dhaka city and also in the proposed special economic zones. The fund could also be used in support o initiatives for workers (e.g. government could take an initiative to build dormitories for workers in such clusters). In case of any adverse outcome originating from a crisis, workers become one of the earliest victims. The government's employment guarantee scheme may need to be made to work in support of the workers.

Bangladesh's exports remain remarkably undiversified. It is overwhelmingly dominated by a single item, readymade garments (RMG) replacing jute. The high commodity and market concentration of exports point to the need for diversifying the export basket as well as the export market for improving Bangladesh's external sector performance. A broad-based industrial development is needed for the growth of diversified manufactured exports. The study also points out the need for adopting public policies for achieving greater utilization of the productive capacity of the economy, leading to a higher growth of exports. Moreover, the issue of the unhealthy concentration of Bangladesh's exports to a few industrialized countries needs to be addressed. Apart from these countries, Bangladesh must endeavour to increase its trade links with other developing countries. Moreover, efforts should be made to establish backward linkages with export-oriented industries, especially with RMG industry with a view to reducing dependence on imported fabrics and ensuring domestic supply of quality fabrics, thereby enhancing value addition from RMG exports.

The external sector of Bangladesh faces some management problems which need to be addressed. Some of these problems relate to (i) managing export incentives, (ii) administering import clearance, (iii) limited control over movements of goods, including some imported goods across borders, (iv) failure to comply with the EU's process criteria and health and environmental standards, thereby exposing the export sector to high vulnerability in recent times. Bangladesh needs to overcome such problems to boost up its economic growth through enhanced trade.

In Bangladesh the trade liberalization process has led to a significant degree of openness of economy as measured by the increased share of merchandize trade in GDP during the period 1981-2008. There has been a large decline in the protection of industries – the average value of effective rate of protection declined from 75.7 percent in 1992/93 to 12.5 percent in 2005-06. Both the openness and the interventionist measures indicated that Bangladesh has achieved an impressive degree of trade liberalization. Thus we find an increase in neutrality of the trade regime through periodic depreciation of the domestic currency and providing incentives to exporters. There is also an increase in liberality through significant reduction in the constraints which existed in export, import and foreign exchange market. The highlights of Bangladesh's experience with trade liberalization are summarized below:

(ii) Through a gradual process Bangladesh has achieved an impressive degree of trade liberalization. There is an increase in both the neutrality and liberality of the trade regime;

(iii) The Bangladesh experience suggests that macroeconomic stability and trade policy reform may be carried out simultaneously and successfully;

(iv) Trade liberalization lead to a higher rate of growth of imports;

(v) A real exchange rate-based liberalized trade regime results in a higher rate of growth of exports;

(vi) A liberalized trade sector has a positive impact on industrial growth;

(vii) Trade liberalization has a positive effect on government revenue. The accelerate trade liberalization provided a shift in the composition of import tariff instruments: from trade-distorting customs duty to trade-neutral VAT and SD; and

(viii) The Bangladesh experience points to the need for fine tuning and careful integration of the trade liberalization policy with reforms in different sectors of the domestic economy.

It must be reiterated that because of the emerging role of WTO, trade liberalization and phasing out of the MFA, Bangladesh is facing a highly competitive world after the year 2004. Bangladesh must act properly to cope up with the ensuing challenges. The response may include (1) maintain a stable macroeconomic environment which is critical to economic growth; (2) establishing backward linkage industries for the RMG sector to the extent that we have long-run comparative advantage in those industries; (3) undertaking serious marketing research for diversification of export market and products; (4) improving product quality and ensuring that products are competitively priced; (5) attracting more FDIs; (6) improving physical and financial infrastructure; (7) ensuring good governance.

We have to make the best out of the evolving global market system. Bangladesh needs to assess the emerging situations arising out of the enactment of the USA Trade and Development ACT 2000 and respond to it with appropriate policy and institutional measures. On behalf of LDCs , Bangladesh should forcefully argue for the grant of duty-free and quota-free access to the products of LDCs. However, in the age of globalization a supportive external environment is a vital necessity. An effective partnership between LDCs and their development partners is essential to face the pervasive challenges of globalization.

To minimize the negative impacts and maximize the positive impacts of globalization, Bangladesh should effectively promote the role of regional and sub-regional trading blocks. This is because deeper integration policies are better pursued regionally than internationally. In order to face the challenges and avail itself with the opportunities over the coming years, Bangladesh will need to design its strategies and policies with due care, attention and diligence to appropriate phasing and sequencing.

On the external front Bangladesh needs to resolve the issues of (i) attracting more FDIs, (ii) the phasing out of the MFA and the GSP under the Uruguay Round Agreement, (iii) regional trade cooperation in South Asia, and (iv) the persistent and growing trade deficits with India. The Uruguay Round Agreement offers opportunities as well as challenges for a developing country like Bangladesh. On the other hand, it provides the opportunity to increase exports by gaining more access to markets in industrial countries; on the other hand, it also raises concerns about the intense competition among developing countries themselves. The present study may assist in pinpointing directions for further research in the field of trade liberalization in terms of both contents and methodology. The experience of Bangladesh may be utilized in formulating some general guideline for undertaking economic growth measures under WTO system in developing countries with similar nature and economic features.

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APPENDICES

Appendix-I

Table A1: Growth of Exports and RMG

(US$ million)						Growth (%)			
		Total Exports	RMG	Woven Garments	Knitwear	Total Exports	RMG	Woven Garments	Knitwear
2002-03	Jul	612.2	473.1	319.5	153.6	-1.2	-5.2	-4.8	5.9
	Aug	1,220.9	948.6	614.8	333.8	5.0	3.2	-4.1	20.2
	Sep	1,727.2	1,318.3	843.0	475.3	7.5	6.1	-1.5	23.0
	Oct	2,187.0	1,626.3	1,035.9	590.4	9.1	6.5	-1.1	23.0
	Nov	2,626.6	1,930.8	1,226.9	590.4	6.8	2.6	-4.7	18.3
	Dec	3,156.4	2,355.8	1,535.1	704.0	5.4	2.9	-3.1	16.2
	Jan	3,725.3	2,790.0	1,833.0	820.7	5.4	2.6	-2.6	14.4
	Feb	4,206.5	3,146.4	2,092.6	957.0	4.4	1.3	-2.9	10.9
	Mar	4,720.1	3,533.7	2,349.6	1,053.8	6.1	3.2	-0.9	12.6
	Apr	5,253.0	3,917.2	2,589.1	1,184.1	7.7	5.1	1.1	14.1
	May	5,869.9	4,383.5	2,923.1	1,328.1	8.5	5.9	3.1	12.1
	Jun	6,545.1	4,912.1	3,258.3	1,460.4	9.3	7.1	4.2	13.4
2003-04	Jul	678.2	530.9	341.7	1,653.8	10.8	12.2	6.9	23.2
	Aug	1,315.1	1,027.2	662.6	189.3	7.7	8.3	7.8	9.2
	Sep	1,898.6	1,450.4	914.9	364.6	9.9	10.0	8.5	12.7
	Oct	2,414.7	1,815.6	1,119.4	535.5	10.4	11.6	8.1	17.9
	Nov	2,972.9	2,223.0	1,357.2	696.2	13.2	15.1	10.6	23.0
	Dec	3,598.3	2,692.9	1,675.7	865.8	14.0	14.3	9.2	23.9
	Jan	4,328.0	3,262.4	2,052.3	1,017.2	16.2	16.9	12.0	26.5
	Feb	4,790.5	3,593.7	2,275.2	1,210.1	13.9	14.2	8.7	25.1
	Mar	5,417.8	4,064.8	2,579.3	1,318.4	14.8	15.0	9.8	25.4
	Apr	6,045.6	4,511.9	2,842.4	1,485.4	15.1	15.2	9.8	25.7
	May	6,761.9	5,043.1	3,158.9	1,669.5	15.2	15.0	8.1	29.0
	Jun	7,598.5	5,685.8	3,538.6	1,884.1	16.1	15.8	8.6	29.8
2005-06	Jul	868.2	681.9	402.0	2,147.2	28.0	28.4	17.6	47.9
	Aug	1,661.9	1,326.3	772.1	280.0	26.4	29.1	16.5	52.0
	Sep	2,311.9	1,831.5	1,052.3	554.2	21.8	26.3	15.0	45.5
	Oct	2,872.4	2,261.3	1,283.8	779.2	19.0	24.5	14.7	40.4
	Nov	3,424.7	2,686.3	1,515.8	977.5	15.2	20.8	11.7	35.2
	Dec	4,142.4	3,226.5	1,823.9	1,170.5	15.1	19.8	8.8	37.9
	Jan	4,785.1	3,740.5	2,117.9	1,402.7	10.6	14.7	3.2	34.1
	Feb	5,409.3	4,229.5	2,410.9	1,622.6	12.9	17.7	6.0	37.9
	Mar	6,089.5	4,725.5	2,675.4	1,818.6	12.4	16.3	3.7	38.0
	Apr	6,961.2	5,171.0	2,907.6	2,050.1	15.1	14.6	2.3	35.6
	May	7,784.6	5,755.3	3,219.6	2,263.3	15.1	14.1	1.9	34.6
	Jun	8,654.5	6,417.7	3,598.2	2,535.7	13.9	12.9	1.7	31.3

Appendix II

Table A2: Important Export-Incentive Schemes in Bangladesh

Scheme	*Nature of Operation*
Export Performance Benefit (XPB)	This scheme was in operation from mid-1970s to 1992. It allowed the exporters of non-traditional items to cash a certain proportion of their earnings (known as entitlements) at a higher exchange rate of WES. In 1992 with the unification of the exchange rate system, the XPB scheme ceased.
Bonded Warehouse	Exporters of manufactured goods are able to import raw materials and inputs without payment of duties and taxes. The raw materials and inputs are kept in the bonded warehouse. On the submission of evidence of production for exports, required amount of inputs is released from the warehouse. This facility is extended to exporters of RMG, specialized textiles such as towels and socks, leather, ceramic, printed matter and packaging materials, who are required to export at least 70 per cent of their produce.
Duty Drawback	Exporters of manufactured products are given a refund of customs duties and sales taxes paid on the imported raw materials that are used in the production of goods exported. Exporters can also obtain drawbacks on the value added tax on local inputs going into production.
Duty Free Import of Machinery	Import machinery without payment of any duties for production in the export sectors.
Back to Back Letter of Credits (L/Cs)	It allowed the exporters to open L/Cs for the required import of raw materials against their export L/Cs in such sectors as RMG and leather goods. The system is considered to be one of the most important incentive schemes for the RMG export. The *Export Policy 2003-2006* extended this facility to all export products.
Cash Subsidy	The scheme was introduced in 1986. This facility is available mainly to exporters of textiles and clothing who choose not to use bonded warehouse or duty drawback facilities. Currently, the cash subsidy is 25 per cent of the free on board export value.
Interest Rate Subsidy	It allows the exporters to borrow from the banks at lower bands of interest rates of 8-10 per cent against 14-16 per cent of normal charge.
Tax Holiday	First introduced under the Industrial Policy of 1991-93, this incentive allowed a tax holiday for exporter for 5-12 years depending on various conditions. In the Export Policy 2003-2006 there was a provision of a tax holiday for five years if an export-oriented industry is set up in Dhaka, Chittagong, and Khulna divisions, but for 7 years in the case of other divisions.
Income Tax Rebate	Exporters are given rebates on income tax. Recently this benefit has been increased. The advance income tax for the exporters has been reduced from 0.50 per cent of export receipts to 0.25 per cent.
Retention of Earnings in Foreign Currency	Exporters are now allowed to retain a portion of their export earnings in foreign currency. The entitlement varies in accordance with the local value addition in exportable. The maximum limit is 40 per cent of total earnings although for low value added products such as RMG the current ceiling is only at 7.5 per cent.
Export Credit Guarantee Scheme	Introduced in 1978 to insure loans in respect of export finance, it provides pre-shipment and post-shipment (and both) guarantee schemes
Special Facilities for Export Processing Zones (EPZs)	To promote exports, currently a number of EPZs are in operation. The export units located in EPZs enjoy various other incentives such as tax holiday for 10 years, duty free imports of spare parts, exemption from value added taxes and other duties.

Source: Government of Bangladesh (2004)

APPENDIX-III

Table A3: Data Set Used in the Regression Process

Year	LGDP	LTLExp	LRMGExp	TL	Capital	LGC	dLGDP	dTLExp	dLRMGExp	dTL	dCapital	dLGC	Cons
1974	3.90671	2.57026	-2	14.3675	14.12564	7.900834	None	None	None	None	None	None	1
1975	4.09549	2.58283	0	16.2162	15.57894	7.983215	0.1887801	0.0125699	2	1.8487	1.4533	0.0823808	1
1976	4.2877	2.58032	-2	17.2193	15.05674	8.636173	0.1922102	-0.0025101	-2	1.003099	-0.5222006	0.6529584	1
1977	4.00359	2.62014	-1.2218	17.6359	16.78453	8.147835	-0.2841101	0.0398202	0.7782	0.4166012	1.727784	-0.4883385	1
1978	3.98373	2.69349	-1.0458	18.1016	16.35648	8.934727	-0.01986	0.07335	0.176	0.4657001	-0.4280491	0.7868919	1
1979	4.12383	2.79156	-0.2757	18.3362	16.8439	9.126327	0.1400998	0.0980699	0.7701	0.2346001	0.4874249	0.1915998	1
1980	4.19273	2.87473	0.4609	19.5371	17.01627	9.332478	0.0689001	0.0831702	0.7366	1.200899	0.1723709	0.206151	1
1981	4.25802	2.85116	0.8663	19.7696	17.62144	9.583971	0.06529	-0.0235701	0.4054	0.2325001	0.6051655	0.2514935	1
1982	4.29585	2.79649	1.1045	21.14861	17.8197	9.708385	0.0378299	-0.0546701	0.2382001	1.379009	0.1982651	0.1244144	1
1983	4.25736	2.8367	1.5139	20.8186	16.97175	9.799737	-0.0384898	0.04021	0.4094	-0.3300095	-0.8479576	0.0913515	1
1984	4.23441	2.90901	2.0807	16.23624	15.91998	9.930665	-0.0229502	0.07231	0.5667999	-4.582359	-1.051764	0.130928	1
1985	4.2938	2.97054	2.177	18.78301	16.31817	10.05822	0.0593901	0.0615301	0.0963001	2.54677	0.3981924	0.1275549	1
1986	4.33471	2.91339	2.4825	17.57098	16.70136	10.21987	0.0409102	-0.0571501	0.3055	-1.21203	0.3831844	0.1616497	1
1987	4.32552	3.03091	2.638	17.2732	16.01625	10.34843	-0.0091901	0.1175201	0.1554999	-0.297781	-0.6851101	0.1285601	1
1988	4.37623	3.09032	2.6797	18.32638	16.31307	10.44993	0.0507097	0.0594101	0.0416999	1.053181	0.2968235	0.1015005	1
1989	4.40889	3.11111	2.8023	19.01026	16.72359	10.55524	0.03266	0.0207899	0.1226001	0.6838799	0.4105225	0.1053095	1
1990	4.42854	3.1829	2.9677	19.65268	17.05412	10.64868	0.0196505	0.07179	0.1654	0.6424198	0.3305283	0.0934401	1
1991	4.47898	3.2349	3.101	18.88985	16.89597	10.73016	0.0504398	0.052	0.1333001	-0.7628288	-0.1581535	0.08148	1
1992	4.49076	3.2997	3.1678	19.93401	17.30503	10.88202	0.0117798	0.0648	0.0667999	1.044159	0.4090652	0.1518602	1
1993	4.50118	3.3771	3.1998	23.12158	17.94683	11.0366	0.0104203	0.0774	0.0320001	3.187571	0.6417923	0.1545801	1
1994	4.5207	3.40378	3.2756	22.86587	18.40256	11.09929	0.0195198	0.02668	0.0757999	-0.2557106	0.4557304	0.0626898	1
1995	4.52851	3.54065	3.396	28.20949	19.11979	11.16498	0.0078101	0.1368699	0.1204	5.34362	0.7172356	0.06569	1
1996	4.57909	3.5891	3.4197	29.77754	19.99322	11.20157	0.05058	0.04845	0.0237	1.56805	0.8734283	0.0365896	1
1997	4.60923	3.64525	3.5355	30.01163	20.72287	11.27548	0.0301399	0.0561502	0.1158001	0.2340889	0.7296448	0.0739107	1
1998	4.62653	3.71275	3.5851	31.6062	21.63242	11.45816	0.0173001	0.0674999	0.0495999	1.59457	0.9095516	0.1826801	1
1999	4.64437	3.72532	3.6188	33.02117	23.00739	11.52114	0.0178399	0.0125701	0.0337	1.414972	1.374977	0.0629797	1
2000	4.65985	3.75983	3.6835	34.41585	23.86188	11.59345	0.01548	0.0345099	0.0647001	1.39468	0.8544807	0.0723095	1
2001	4.67299	3.81072	3.6623	36.88216	23.08702	11.64615	0.0131397	0.05089	-0.0211999	2.466309	-0.7748585	0.0527	1
2002	4.67166	3.77707	3.6674	33.323	23.14749	11.82511	-0.0013299	-0.0336499	0.0050998	-3.559158	0.0604744	0.1789608	1
2003	4.67681	3.81613	3.7201	34.24911	23.40531	11.98735	0.0051498	0.0390599	0.0527	0.9261093	0.2578163	0.16224	1
2004	4.71453	3.88098	3.7937	36.27827	24.0231	12.12306	0.0377202	0.0648501	0.0736001	2.02916	0.6177959	0.1357098	1
2005	4.7534	3.93874	3.8389	38.65583	24.4	12.22826	0.0388699	0.05776	0.0452001	2.37756	0.3768959	0.1051998	1
2006	4.77839	4.02226	3.951	39.87697	24.56724	12.38544	0.0249901	0.0835202	0.1120999	1.221138	0.167244	0.1571789	1
2007	4.79167	4.08557	3.9708	39.98743	24.79477	12.76593	0.0132799	0.0633097	0.0197999	0.1104622	0.2275276	0.3804922	1
2008	4.83608	4.14955	4.0748	41.0478	25.76484	12.99479	0.0444102	0.0639801	0.1040001	1.060368	0.970068	0.2288609	1