Bangladesh's Export Sector: Changes and Challenges

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From Aid-Dependence to Trade Dependence

In the recent past Bangladesh's macroeconomic performance has come to be increasingly dependent on the performance of her external sector. This is manifestly demonstrated by the shift in the relative importance of aid and trade in the economy of the country. In 1990 total disbursed aid was equivalent to 8.1% of Bangladesh's GDP; in 2000 the share had come down to 4.0%; exports as a percentage of GDP, on the other hand, has gone up from 6.8% to 14.5% over the same period. In 1990 the country's earnings of the foreign exchange from export and remittance was 1.3 times that of the aid disbursed; by the year 2000 it was almost 5 times as high. Bangladesh's graduation from a predominantly *aid recipient* country to a predominantly *trading country* is one of the major achievements of the 1990s. The structural shift from *primary to manufacturing* exports, from *resource-based* to *process based* exportables and from the traditional *jute-centric* to the emergent *RMG-centric* export is remarkable by any standard. Over the same period the country had also to import an increasing amount of production and non-production related commodities. Increasing exports have allowed the country to service a large part of this growing import demand without seriously undermining the balance of payments position of the country and the country's debt servicing record.

Consequently, in view of the increasing degree of openness of the Bangladesh economy, factors such as competitiveness of the external sector, market access capacity and ability for strengthened global integration are becoming key determinants in terms of not only the performance of the external sector but also the overall growth and development of the country. The present paper traces the growth dynamics of Bangladesh's export sector in terms of a number of major correlates and looks at some of the major challenges which are expected to impact on export sector performance in the short and medium terms.

Export Sector Dynamics in Recent Years

Growth Performance

Bangladesh's external sector has experienced fluctuating fortunes in recent years. Export growth rate in FY1997 and FY1998 were a robust 13.8% and 16.8%, only to subsequently came down to 2.9% in FY1999, in part as a consequence of the 1998 flood. In FY2000 export sector was able to make some rebound and posted a growth of 8.3% compared to FY1999. This growth rate was, however, below the trend growth rate of about 12.0% for the 1990s and was built on the relatively lower base of the previous fiscal year.

A development of some concern to Bangladesh in FY2000 was the deceleration in the growth of woven-RMG sector, the single-most important sector accounting for 56.0% of total exports. RMG registered a growth of only 5% in FY2000. This, in effect pulled down the exports earnings in FY2000 to the level of $5.7 billion, resulting in the relatively low growth of 8.3%. A positive development though was the continued robust performance of the knit-RMG exports, which having registered a growth of 10.4% in FY1999, was able to grow by 22.6% in FY2000. The share of the sector in total export has doubled over the last five years, form 12.0% to 22.0%. This is clearly demonstrated by Table-1.

Table 1: Structure of Exports, Incremental Exports and Net Export

(in percent)

Commodities	**Structure of Export**		**Structure of Incremental Export**		**Structure of Net Export**		**Growth of Net Export in FY2000 over FY1999**
	FY1999	**FY2000**	**FY1999**	**FY2000**	**FY1999**	**FY2000**	
Raw jute	1.3	1.2	-23.8	0.0	2.4	2.2	-0.2
Tea	0.7	0.3	-5.8	-4.8	1.3	0.5	-54.2
Frozen food	5.2	6.0	-12.6	15.8	9.2	10.5	25.3
Primary Commodities	**7.9**	**8.2**	**-52.5**	**10.7**	**14.2**	**14.3**	**11.1**
Jute goods	5.7	4.6	14.8	-8.6	10.2	8.1	-12.5
Leather	3.2	3.4	-14.5	6.1	5.7	6.0	15.9
Woven RMG	56.2	53.6	93.3	22.2	33.4	31.4	3.3
Knit RMG	19.5	22.1	62.7	53.4	23.2	25.9	22.6
Chemical products	1.5	1.6	3.2	3.3	2.7	2.9	18.1
All Mfg. Commodities	**92.1**	**91.8**	**152.4**	**89.3**	**85.8**	**85.7**	**9.8**
Total (million US$)	***100 (5312.9)***	***100 (5752.2)***	***100 (151.7)***	***100 (439.3)***	***100 (2679.5)***	***100 (2946.5)***	***9.9***

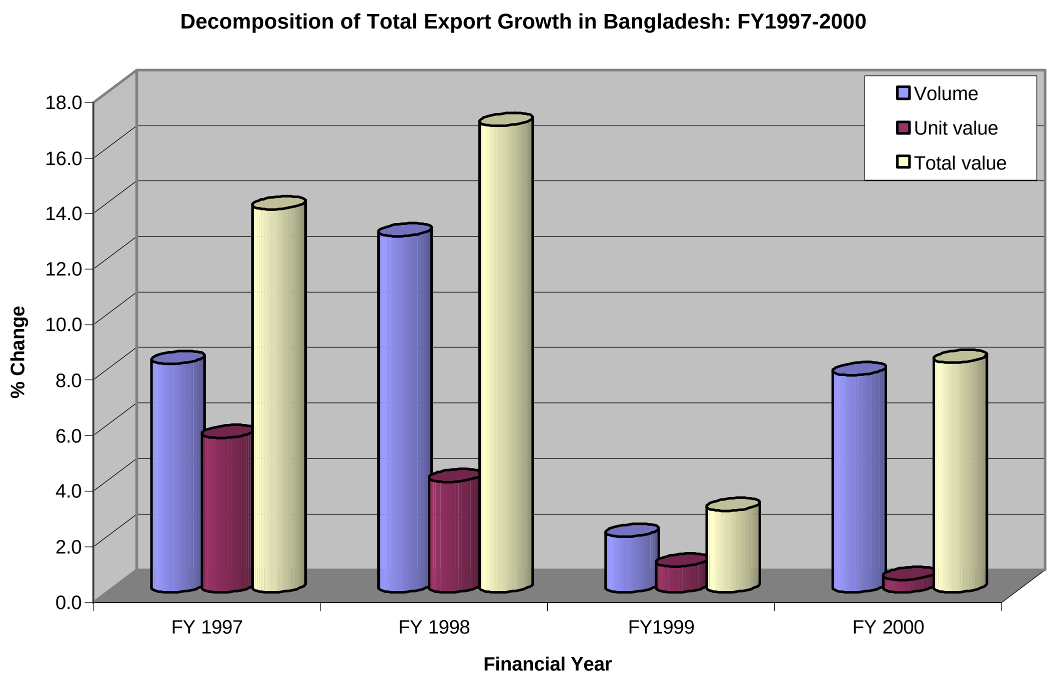
Source: Compiled from EPB Annual and Monthly Data

An interesting development of recent years is that since the local value addition of knit-RMG is relatively high (50% as against 25% for woven-RMG) its share in net exports is gradually catching up with that of the woven-RMG. If the structure of incremental export is analysed, this growing importance is even more clearly manifested. For every dollar of incremental export earned by Bangladesh in FY2000 53 cents was contributed by knit-RMG. In FY2000 other important exportables such as jute goods (4.6%), frozen food (6.0%) and leather (3.4%) performed below the levels achieved during recent years.

Decomposition of Export Growth

As is evidence by Figure-1, in recent years an increasing share in the incremental growth is originating from changes in the *volume index* as compared to that of the *price index*. This trend is a cause for major concern which was first pointed out in IRBD1998/99 and has continued to persist in FY2000 as well. In FY2000 the increase in unit price value contributed only 0.5% to the growth in total exports, which was 8.3%; compared to this the increase in export volume contributed 7.8%. This would imply that the weak growth rate of prices of our principal exports in the international markets has to be increasingly compensated for by an ever-increasing volume of exports. The underlying dynamics of the changes in price, volume and value indexes is easily discernible from Figure 1. The price trend perhaps also reflects deterioration in Bangladesh's terms of trade in recent years. If FY1980 is taken to be the base year, the terms of trade has come down to the level of 89.2 in FY2000.

Figure 1



Source: Computed from EPB data

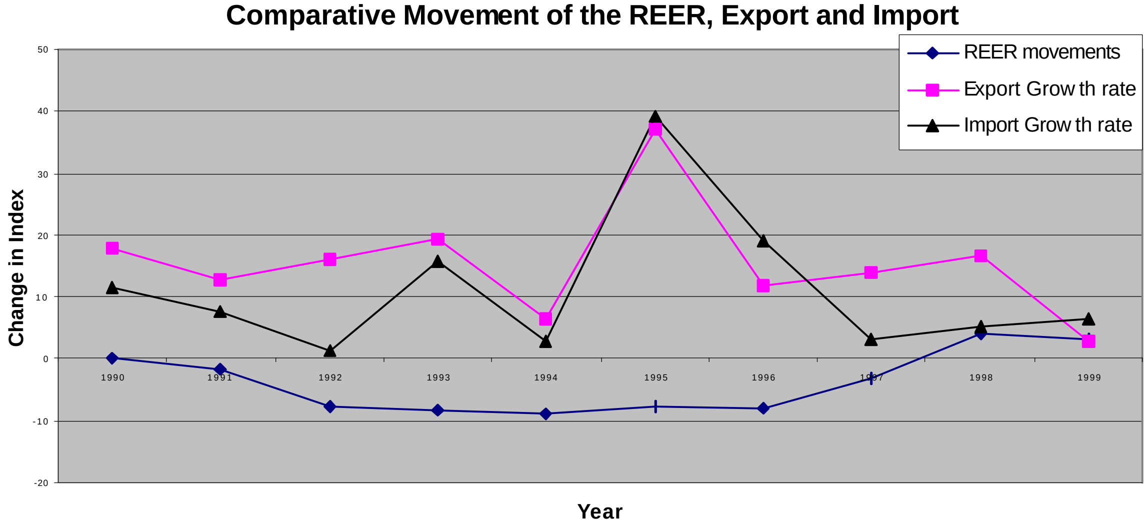
Exchange Rate Policy and Export Performance

In the recent past Bangladesh has resorted to frequent depreciation of the *taka*. Through this flexibility in the nominal exchange rate was maintained in line with movements in the real effective exchange rate. In all, the taka has been devalued 18 times over the tenure of the current government, which led to a cumulative depreciation of the currency to the extent of 19.1%. Maintaining external competitiveness of Bangladeshi exports and minimising adverse developments in the balance of payments position of the country were often cited as the principal rationale for pursuing such a policy. Exchange rate policy was also mentioned in the budget speech of the Finance Minister on 8 June, 2000 as one of the major policies to stimulate export sector of the country.

Such a policy of creeping devaluation is consistent with the need to maintain exchange rate flexibility in order to sustain Bangladesh's export competitiveness. However, if we track the movement of the *real effective exchange rate* (REER) over the 1990s, it will be seen that the *taka* actually appreciated for most of the 1990s despite the frequent nominal devaluations. It was only subsequent to December, 1997 that the taka actually started to depreciate in real terms. It is also of interest to note here that no discernible correlation is visible between the movements in the REER and the growth rates of either Bangladesh's exports or imports. Figure-2 brings out this mismatch very clearly. It appears that other structural factors, specially supply side constraints and global market dynamics play a more important role in stimulating exports and improving the balance of payments position compared to movements in the nominal and real exchange rates.

Figure 2

Comparative Movement of the REER, Export and Import



Source: IMF, Bangladesh Bank and EPB

Remittance, Aid and the Pressure on Foreign Reserve

In recent years the relatively slow growth performance registered by Bangladesh's commodity export sector was somewhat compensated by the robust growth of the remittances sent by Bangladeshis working abroad. As was pointed out earlier, in the recent past this increased inflow had a positive impact on the current account transfer and the balance in current account of the country. Table-3 shows the dynamics of remittance in recent years.

Table 3: Dynamics of Growth of Remittance: FY1995 - FY2000

Indicators	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**
Remittances (in million US$)	1198	1217	1475	1525	1709	1953
Growth of Remittance (%)	10.0	1.6	21.2	3.4	12.1	14.2
Growth of Exports (%)	37.1	11.8	14.0	16.8	2.9	8.3

Source: Compiled from Bangladesh Bank data.

As can be seen from Table-3, remittances have registered a robust growth of 14.2% in FY2000 compared to FY1999. This was almost double the growth of exports during the corresponding period. The growth rate of remittances in FY1999, at 12.1%, was also substantially higher than the growth of exports in FY1999, which was only 2.9%.

Current Account Balance and Reserves

The increasing flow of remittance reflects, at least in part, the incentives for inward remittances through legal channels under the current market determined exchange rate system. Increased flow of remittances have played an important role in replenishing the forex reserves of the country in recent years. Given the potential for exchange earning capacity of this sector, there is need to design a comprehensive plan for skill upgradation of her immigrant labourers. Towards this a comprehensive labour market survey and a study to determine domestic skills upgradation capacity need to be undertaken on an urgent basis.

Foreign aid commitment for FY2000 was equivalent to $1480.9 million, which was significantly lower than the corresponding commitments for the same period in FY1999, which was $2648.5 million. Thus, commitments came down by about 44.0% in FY2000. This decrease was mainly due to drastic fall in commitments for *food* and *commodity aid*. However, it is to be noted that *project aid* commitments also came down significantly over this period, from $2017.2 million to $1254.5 million- a fall of 37.8%. Throughout the 1990s disbursement of *project aid* as a percentage of commitment had experienced a sharp decline.

In spite of the robust growth of the remittances, the substantial deficit in the trade account (equivalent to about $1.1 billion in FY2000) and low aid disbursed during FY2000 meant a growing pressure on the reserves which came down to about 1.6 billion by the end of FY2000. Evidently, with imports picking up, it was around 20% during the first quarter of FY2000, from the low growth of 1.6% registered in FY2000, the pressure on the reserves is expected to go up in the coming months. The foreign exchange reserve in the 1990s peaked in FY1995 when reserves reached $3.07 billion, which was equivalent to 6.3 months of imports. Since then reserves have declined steadily to reach about $1.3 billion in recent months, is expected to lead to major changes in the area of competitiveness in global apparels market. Once the quotas are removed, and preferential margins are gradually eroded, comparative advantage scenarios which informed the market behaviour under the MFA regime will be subjected to radical change. New entrants such as Cambodia, Laos and Vietnam will also bring more competitive pressure into the market. Bangladesh will need to make a comprehensive study on the implications of these developments, and design an adequate strategy to address the attendant issues.

Export Sector and FY2000 Budget Responses

Over the past years Bangladesh's policies have tended to focus on exchange rate management and export promotional incentives as two important instruments to boost the country's export and in order to stimulate export sector diversification in the country. The taka was devalued eighteen times during the tenure of the present government - twice during FY2000. Export sector has also received substantial amount of financial help in the form of subsidies and other forms of assistance. Such assistance amounted to Tk. 635.0 Crore ($131.3 million) in FY2000 alone. Budget FY2001 also makes an allocation of another $126.4 million towards this. The budget also provides for general reduction in the duties on basic raw materials (5% on average) and intermediates and semi-finished goods (15% on average) with a view to stimulate export-oriented investment in the economy. Duties on various raw materials used in the textiles, leather, footwear and some other export-oriented industries have also been brought down in the budget for FY2001.

The budget provides for a number of incentives to stimulate non-traditional exports. To promote export-oriented agro-processing industrialisation duty rates on machinery, spare parts, raw materials and packaging materials of agro-processing industries have been substantially reduced. To encourage export-oriented activities in the jewellery industries, the import quota of gold has been doubled and duty rate reduced. A lump allocation equivalent to Tk. 150 million has been kept with a view to encourage training of programmers and for promoting Bangladesh's emerging IT sector.

It is becoming increasingly evident that technology in the RMG sector is becoming a key determinant of Bangladesh's continued competitiveness in the global apparels market. Bangladesh's *low wage based comparative advantage* needs to be translated into *productivity based competitive advantage* and it is here that technology comes to play a crucial role. Although zero-tariff access of capital machineries and other incentives are welcome initiatives of GOB in this respect, more vigorous efforts and comprehensive approach are required.

An important initiative of budget FY2001 is the decision to allocate Tk. 1.0 billion for estabilising an *Equity Development Fund* in the Bangladesh Bank with the objective of promoting investment in software export and agro-processing industries. The fund will be invested in financially viable software, food processing and agro-processing activities; maximum investment from this fund will be limited to 25% of the equity. It is hoped that this dedicated fund will give a boost to two sectors which appear to have high export potentials.

It needs to be appreciated and given due recognition that the fiscal, financial and institutional incentives provided to the export sector and export-oriented activities in Bangladesh in the recent past have played an important role in ensuring the 12% average real growth rate of the sector in the 1990s. However, lack of adequate infrastructure facilities, absence of infusion of technology in export-oriented sectors and weakness in the management of the sector have severely constrained the sector's performance and its move towards a diversified base. Major concerns continue to severely constrain realisation of many of the potential opportunities which globalisation offers to Bangladesh. If Bangladesh fails to address these concerns, needless to say, the attendant risks will became originating from globalisation even more acute.

Major Issues to be Addressed

Continuing Narrow Export Base

Narrow export base and lack of diversification of exports has led to a situation where the Bangladesh's export sector performance has come to predominantly hinge dependent on the performance of the RMG sector. Global market of textiles and apparels is around $300 billion and there is a wide intra-market diversity. Thus, *perse* dependence on exports of RMG should not *by itself* be a major concern. What is of more concern are the followings: (a) exports have continued to remain concentrated in the lower segment of the demand curve; (b) local value addition has been delimited to 25-30%; (c) product and process modification cpacities have not improved significantly because of constraints in the areas of technology and skills; (d) limited backward and forward linkages. There is also lack of product diversification within the RMG sector itself. Till now any discernible shift favouring higher value-added fashionable product categories in the RMG market is not visible. As a result potential market opportunities continue to remain unaccessed.

In view of the growing RMG-centric export base in Bangladesh, the growth dynamics of the sector needs to be put under close scrutiny. Any deceleration in the performance of this particular sector severely tests the efficacy of Bangladesh's export-led growth strategy. As quotas increase across countries in the run up to the year 2005 (MFA quota will increase at the rate of 16%, 25% and 27% over the first three stages of MFA phase out), a process of restructuring of the global RMG market is expected to gradually evolve where price competitiveness and quality aspects will predominantly dictate the market behaviour. The slow-down in the growth of woven-RMG in FY2000 should serve as a wake up call specially in view of (a) the upcoming third phase of the integration of *Multi-Fibre Arrangement* (MFA) into the *Agreement on Textiles and Clothing* in WTO (ATC) and its potential consequences for Bangladesh's apparels sector; (b) China's entry into the WTO; (c) structural shifts in sourcing of apparels by USA following establishment of NAFTA; (d) the recently enacted *Trade and Development Act of 2000* in USA which provides zero tariff and quota-free access to US markets to 72 African and Caribbean Basin countries and (e) heightened competition in the EU market in view of granting of quota-free access to Bangladesh's major competitors in 2005.

Bangladesh will need to carefully study why in recent years Bangladesh's quota-fill performance in some of the traditionally important categories of apparels export has registered a significant decline. Careful analysis should be carried out as to why Bangladesh's performance in a number of categories has not matched those of the corresponding period of the last year. In this context Bangladesh should also monitor the quota fill performance of some of the competitors including Sri Lanka, China, India and Pakistan.

The rising importance of knit-RMG, contributing an increasing share in both net exports and incremental exports, needs to be given special attention. The local value addition in the knit-RMG sector varies from 50% to 60%, which is double the current level in the woven-RMG sector. It is of importance to note that Bangladesh's knit-RMG sector was able to demonstrate a quite robust performance in recent years within the quota-free environment in the EU. However, one of the underlying factors contributing to this success is the fact that, major competitors of Bangladesh in the EU market such as India and Pakistan are compelled to operate under quota restrictions. Such quotas will be eliminated as of January 1, 2005. In view of the promise of this particular sector, specially in the context of possible deceleration in the growth of woven-RMG exports, it is of critical importance that a comprehensive policy package be developed in order to stimulate the competitive strength of the export-oriented knit-RMG sector of the country.

Over the recent years, imports of capital machineries for textile industries have registered significant growth, testifying to some degree of backward linkage activity taking place in the export-oriented apparels sector. A comprehensive strategy to stimulate such backward linkage activities ought to be designed and implemented on an urgent basis.

This is essential on four counts: (a) to face the challenges of post-MFA regime; (b) to comply with stringent rules of origin requirement for accessing GSP; (c) to increase local value addition and (d) to create employment opportunities within the country. Of course a strategy for developing the backward linkage industries must of necessity take into cognisance the dynamic comparative advantage of Bangladesh in a fast changing global market.

Shifts in Global Market Opportunities

The recently introduced US Trade and Development Act of 2000 (US TDA2000) provides duty and quota free access for textiles products to US markets from 72 countries under the Africa Growth and Opportunity Act and the US Caribbean Basin Trade Partnership Act. The benefits under the Act is to be offered from October 1, 2000 and will continue till September 30, 2008. The bill, subject to fulfillment of certain conditionalities, provides the aforementioned countries, in effect, a NAFTA - parity. Since a number of the beneficiary countries, specially some of the Caribbean countries are major textile exporters to the US market and compete with Bangladesh in some of the important product categories, Bangladesh will need to carefully study and monitor the implications of this Act in terms of the future export performance of the country's RMG sector in the US market.

China's Entry into the WTO System

Till Bangladesh's debt-servicing record had been one of the best amongst the LDCs - at less than 10% of her forex earnings from exports of commodities and remittances. The pressure on reserves is also expected to go up on account of gas purchase and sales agreement (GPSA) with IOCs. As of now these payments are equivalent to about $100.0 million but is expected to go up to about $500 million over the immediate future. Bangladesh will need to ensure increased export earnings from export and remittance in order to service these claims without adverse impact on imports and forex reserves of the country. Energetic steps will need to be taken to maintain this good record.

Challenges Originating from Globalisation

Emerging market access problems, phase out of the MFA, commitments under the WTO pertaining to gradual withdrawal of subsidies, the need to conform with standards such as ISO-9000 and ISO-1400 and persistence of protectionist trends in developed country markets have confronted LDCs such as Bangladesh with new challenges in the era of globalisation. As the spokesman of the LDCs Bangladesh also has an added responsibility to articulate the voice of the LDCs in the various global trade platforms. Voices are being raised in many LDCs as to the justification of any new round of trade negotiations under the WTO at a time when most of the promises favouring the LDCs during the Uruguay Round (Special and Differential status, technical assistance, strengthening of the aid-trade nexus, greater market access, technology transfer etc.) are yet to be implemented. As leader of the LDCs

Bangladesh should also feel an added responsibility to ensure that the objectives of the Integrated Framework Initiative of the six agencies which is designed to address the technical assistance needs of the LDCs are achieved. The LDCs and developing countries also need to explore the possibility of designing common approaches in future WTO negotiations. GATT UR provisions stipulates that, under the WTO provisions countries get not what they deserve, but what they negotiate. It is, thus, important that the LDCs raise their bargaining strength by pooling their resources in any future negotiations. This is more so because future trade battles will be mainly waged in such WTO forums as the dispute settlement body (DSB) which are becoming increasingly important in terms of enforcement of the global trade regime. Low domestic capacities of LDCs to put forward their cases is being manifested in the form of constrained market access, imposition of anti-dumping and countervailing duties, as also in terms of interpretation of the Uruguay Round provisions in ways which tend to go against the interests of the developing countries on the one hand, and the spirit of multilateral negotiations, on the other hand. Thus, whilst acting locally Bangladesh will need to coordinate her policies globally as an LDC. The task of monitoring the impact and implications of the WTO provisions and decisions is an on-going continuous process. Thus, the Special and Differential Status given to the LDCs in the WTO and Decisions on Measures in Favour of Least Developed Countries annexed to the Final Act of the Uruguay Round needs to be carefully studied and monitored by Bangladesh in order to guarantee maximum advantage for the LDCs.

Concluding Remarks

It is perhaps of some interest to note that Bangladesh's export sector has demonstrated a good recovery during the first quarter of FY2001 (July-September, 2000). Export accruals during the first quarter for FY2001 was about 25.4% higher compared to the corresponding period of FY2000. In terms of growth rate, export earning performance of some of the major sectors including woven-RMG (20.5%) and knit-RMG (31.2%), frozen foods (54.6%) and leather (5.4%) was significantly better compared to the corresponding period of FY2000. However, the export base has continued to remain narrow and no mentionable breakthrough in the performance of the thrust sectors is visible. The growth in export was mainly achieved thanks to increase in volumes rather than that of price. The contribution of price index to the incremental export over the first quarter of FY2001 was 12.9%, whilst that of volume index was 87.1%. With MFA phase-out programme gradually nearing its completion, Bangladesh will also be required to increase her vigilance in terms of monitoring the global dynamics in apparels and textile markets in the coming months and years. This is specially so since price levels of most of the apparel categories is expected to experience a sharp decline once the MFA phase-out is completed.

The GOB needs to recognise the enormity of the challenges confronting Bangladesh under the new global order and will have to equip itself adequately to meet these challenges. The GOB will need to design a dynamic export strategy and put in place the capacity to realise such a strategy rather than just talk about it. To carry through such an exercise in intelligent policy design and its implementation, GOB will need both strong political commitment as well as good governance, and will also be required to pursue a proactive external policy underwritten by coalition-building and skillful negotiating strategies. To this end, it will need to draw upon the best available professional resources in the country as well as draw in external expertise in selected areas. Priority should be given to preparing a joint action agenda with other LDCs which need to be pursued in any future round of trade negotiations. This task is of immediate importance also in view of the forthcoming *Third LDCs Conference* which is to be held in Brussels in May, 2001.