# MIMAP Bangladesh

## Micro Impacts of Macroeconomic and Adjustment Policies in Bangladesh

Working Paper No. 6

# Bangladesh: External Sector Performance and Recent Issues

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# Bangladesh: External Sector Performance and Recent Issues

***-- Mustafa K. Mujeri***

## *Abstract*

Since independence, Bangladesh's external sector witnessed intensive reforms and policy changes in response to strong arguments favouring a liberal trade regime. The realization of benefits of trade reforms, however, remains a matter of controversy. The paper provides a brief review of the changes in trade policies along with movements in trade-related indicators and implications on economic growth. It is argued that trade reforms do not readily bring benefit for the Bangladesh economy and the standard arguments favouring trade liberalization are not necessarily applicable to the country. Trade liberalization has both benefits and costs and Bangladesh gained relatively little from past trade reforms since the policies were not adequately linked with, and shaped by, domestic realities. The paper argues that the recent instability in the external sector is deeply rooted in structural weaknesses of the external sector and the domestic economy. In part, this has resulted from pursuing trade liberalization as the driving force of economic reforms with inadequate support of complementary reforms. The situation also highlights the increased volatility of the relatively more open domestic economy to external shocks. It is argued that trade reforms in Bangladesh need to remain sensitive to social costs, shaped by domestic policy regime, supported by safety nets for the affected people, and guided by institutional capacity. For Bangladesh, it is also important to establish an early warning and effective information system for the external sector to guard against possible slippage and design quick response to adverse developments.

# 1. Introduction

Since independence in 1971, Bangladesh's external sector witnessed, relative to other sectors, more intensive reforms and policy changes. The country started with a restricted trade regime and a reversal of the policy towards a liberalized external sector began in 1975.[1] After the mid-1980s, a more comprehensive programme of stabilization and economic reforms was implemented aiming to create an open, liberalized, and market-oriented economy.[2] Under the programme, the creation of a liberal trade regime was emphasized for greater integration of domestic economy with the global economy to improve internal and external competitiveness and accelerate export-led growth. The argument was that such a strategy would relax the constraints of small domestic market and provide access to foreign direct investment facilitating technology transfer, creating marketing network, and providing much-needed managerial and technical skills. While the potential benefits were well-argued as evidenced by the relatively quick implementation of trade reforms compared with other reforms in the country, how far the benefits have been realized is a matter of controversy.

The present paper provides a brief review of Bangladesh's external sector in the light of major changes in trade policies in order to identify emerging concerns. The focus will be on the 1990s when rapid trade liberalization was implemented. The paper argues that the recent instability in the external sector e.g. 'crisis' in export performance, mounting pressure on external balances, and falling foreign exchange reserves at uncomfortable level is deeply rooted in structural weaknesses of the external sector and the domestic economy. In part, this has resulted from pursuing trade liberalization as the key driving force of economic reforms with inadequate support of complementary domestic reforms. The situation also highlights the increased volatility of the relatively more open domestic economy to external shocks e.g. global economic recession and September 2001 events in the United States.

[1] The inward looking policies of the period highlighted the concerns to conserve foreign exchange, create the industrial base through a protective domestic environment, and maintain a sustainable balance of payments. Strong arguments, however, were put forward against these policies on the ground that such policies had led to distorted incentive structures creating allocative and productive inefficiencies, external sector strains and anti-export bias, and slow growth. Trade and other reforms which started in the mid-1970s were linked to policy based lending of the IMF and Import Programme Credit (IPC) of the World Bank.

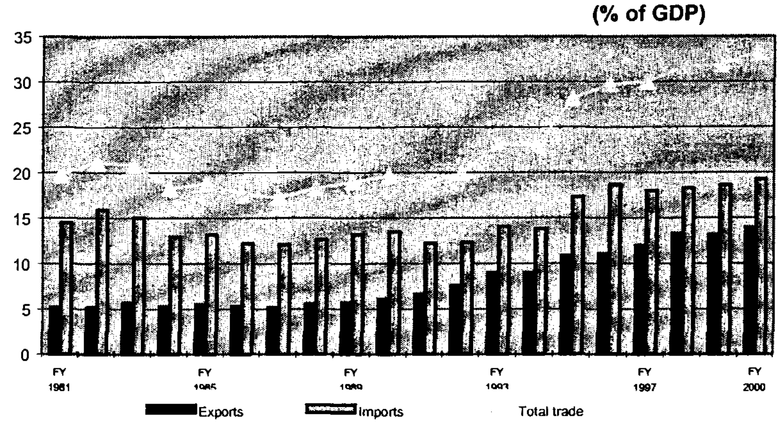
[2] The programme covered different measures including fiscal, financial, trade and industrial policy reforms; public resource management; privatization; and institutional and sectoral reforms. These economy-wide reforms and structural adjustments, initiated in 1987, formed parts of the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF) of the IMF and the World Bank. For details see Sobhan 1991, Mujeri et. al. 1993.

The paper is organized as follows. Section 2 provides a brief summary of Bangladesh's major trade-related indicators and their implications. Section 3 examines changes in trade policies and impact on economic growth. Finally, Section 4 reviews the recent external sector performance. Within the limited scope of the paper, a broad descriptive approach has been adopted to provide a plausible account of the implications of trade reforms and future prospects.

## 2. The External Sector: Major Changes

At the aggregate level, the growth and structural changes in merchandise trade can be seen in Table 1. Compared with an average annual growth of around 8 per cent in the 1980s, exports in both volume and value terms increased by 13 per cent in the 1990s. In case of imports, the rates increased substantially to 9 per cent for volume and 12 per cent for value in the 1990s compared with less than 2 per cent for volume and 4 per cent for value in the 1980s. The trade basket indicates an increasing concentration of a broad category (manufactured goods) accounting for 91 per cent of total merchandise exports in 1998. The category consists of an assortment of simple manufactured goods e.g. readymade garments, leather and leather manufactures, fabrics, and made-up articles.[3] This indicates that the country's exports increased through exporting more of same or similar goods and, from this perspective, displayed little dynamism. Nevertheless, the share of foreign trade (exports and imports) in GDP increased to 33 per cent in 2000 from around 20 per cent in the early 1980s (Figure 1).

**Figure 1: Importance of Foreign Trade**



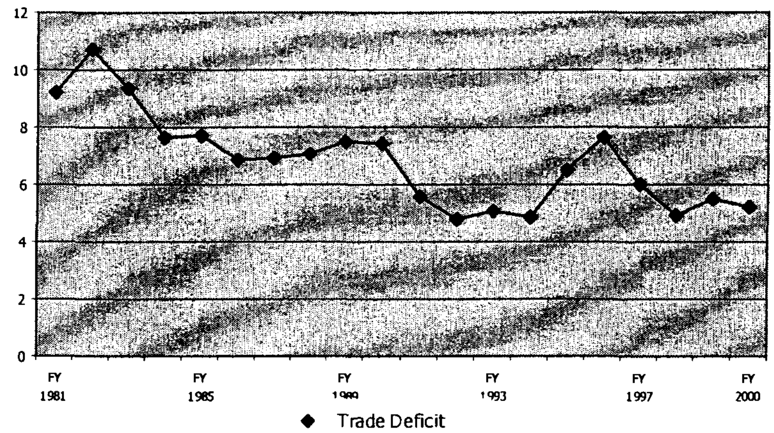

Sources: MOF 2001, BBS 2001

[3] According to one study, the share of skill-intensive goods (e.g. chemicals, electrical and non-electrical machinery, computers and office equipment, communication equipment and similar products) in manufactured exports was 4 per cent for Bangladesh and 38.7 per cent for India in 1996, 2.4 per cent for Nepal and 2.9 per cent for Pakistan in 1997, and 9.2 per cent for Sri Lanka in 1994. See Mayer and Wood 2001.

## 2.1 Overview of Trade Flows

Bangladesh has been facing a persistent deficit in its trade account (Figure 2). Despite a rapid increase in import-GDP ratio, the trade deficit as a percentage of GDP was lower in the 1990s compared with the 1980s due to a relative strong performance of the

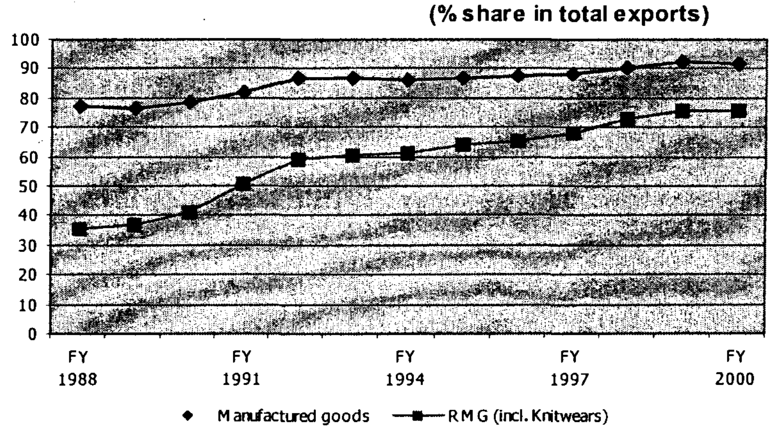
**Figure 2: Measure of Trade Deficit**
**(% of GDP)**




Sources: MOF 2001, BBS 2001

export sector. The increase in exports came largely from non-traditional sectors (e.g. readymade garments and knitwears) as can be seen from the steadily increasing shares of exports of manufactured goods and readymade garments (including knitwears) in total exports (Figure 3).

**Figure 3: Composition of Exports**
**(% share in total exports)**




Sources: MOF 2001, BBS 2001

## Table 1

### Growth and Structural Change in Merchandise Trade

| A. Growth | | | |
|---|---|---|---|
| | | Average annual % growth | |
| | | 1980-1990 | 1990-1997 |
| Exports | | | |
| | Volume | 7.6 | 12.9 |
| | Value | 7.6 | 13.2 |
| Imports | | | |
| | Volume | 1.8 | 9.1 |
| | Value | 3.7 | 11.8 |

| B. Structural Change | Merchandise exports | | Merchandise imports | |
|---|---|---|---|---|
| | 1980 | 1998 | 1980 | 1998 |
| Total value ($ million) | 793 | 5,141 | 2,353 | 6,862 |
| | | % of total | | |
| Food | 12 | 7 | 24 | 15 |
| Agricultural raw materials | 19 | 2 | 6 | 5 |
| Fuels | 0 | 0 | 9 | 7 |
| Ores and metals | 0 | 0 | 3 | 2 |
| Manufactures | 68 | 91 | 58 | 69 |

Source: World Bank 2000.

The broad composition of export and import baskets reveal several features (Table 2). In case of exports, extreme concentration of a single group is dominant. In the early 1980s, more than 84 per cent of exports came from industrial supplies (e.g. jute and jute goods, leather etc.), while in the 1990s, the concentration has been in consumer goods (mainly readymade garments and knitwears) accounting for 80 per cent of exports in 1999.[4] This shows the extremely narrow base of the country's export sector with its associated disadvantages. It has, however, been argued that Bangladesh's export structure, as in other South Asian countries, can be explained by its average combination of existing human and natural resources (Mayer and Wood 2001).[5] In case of imports, a shift towards increased share of consumer goods imports can be observed.

[4] Such a concentration of exports in readymade garments is unusually high in the global context. During 1997, garments and knitwear exports accounted for 68 per cent of total exports in Bangladesh which was 49 per cent in Sri Lanka, 29 per cent in Korea and less than 8 per cent in China. During early 1970s when Korea relied heavily on garment and textile exports, the share reached about 45 per cent of its total exports. See IMF 2000.

[5] Based on an analysis of the determinants of South Asia's export structure, the authors conclude that Bangladesh's average export structure and export concentration result mainly from a low level of education and few natural resources relative to its high labour supply.

## Table 2

### Broad Composition of Export and Import Baskets

(Per cent)

| | | Exports | | Imports | |
|---|---|---|---|---|---|
| | | 1981 | 1999 | 1981 | 1999 |
| 1. | Food & beverages | 12.3 | 6.3 | 14.3 | 21.6 |
| | Processed/unprocessed for industry | 0.5 | ... | 11.1 | 12.2 |
| | Processed/unprocessed for households | 11.8 | 6.3 | 3.2 | 9.4 |
| 2. | Industrial supplies | 84.3 | 12.4 | 49.6 | 50.6 |
| | Primary | 17.0 | 1.7 | 20.2 | 5.6 |
| | Processed | 67.3 | 10.7 | 29.4 | 45.0 |
| 3. | Fuel & lubricants | ... | 0.1 | 8.8 | 7.4 |
| 4. | Machinery & other capital equipment | 1.4 | 0.8 | 15.1 | 11.6 |
| 5. | Transport equipment & accessories | 0.3 | 0.2 | 9.2 | 4.7 |
| 6. | Consumer goods | 0.9 | 80.0 | 2.2 | 4.0 |
| 7. | Goods N.E.S. | 0.8 | 0.2 | 0.8 | 0.1 |
| | Total | 100 | 100 | 100 | 100 |

Source: BBS 2001.

## 2.2 External Competitiveness

Since the 1980s, Bangladesh performed reasonably well in achieving an impressive growth in exports (Table 3). However, the better performance does not necessarily hide the weaknesses particularly relating to export concentration. Since the export structure in Bangladesh is highly labour-intensive, the main determinant of export competitiveness is the

## Table 3

### Bangladesh's Export Performance: South Asian Perspective

| | Exports of goods and services | Exports as % of world exports |
|---|---|---|
| | *Average annual growth (%) 1980-1997* | *1995-1997* |
| Bangladesh | 10.0 | 0.08 |
| India | 7.8 | 0.63 |
| Nepal | 8.3 | ... |
| Pakistan | 7.0 | ... |
| Sri Lanka | 7.8 | 0.08 |

Source: World Bank 2000, IMF 2000.

unit labour cost (e.g. the ratio between labour cost per worker and productivity). In order to be competitive, Bangladesh's unit labour cost should be at least as low as that of its competitors so that wage and productivity levels are competitive in world markets. Here, we shall try to give some information on movements in labour cost and productivity in the manufacturing sector (Table 4). In Bangladesh, between mid-1980s and late-1990s, the labour cost per worker in manufacturing increased by nearly 21 per cent but value added per worker declined (by 6 per cent). As a result, value added per $ of labour cost declined. This is in sharp contrast to India and Sri Lanka where increasing trends can be noted.[6] It may, however, be noted that, during 1997, 47 per cent of value added in manufacturing of Bangladesh came from textiles and clothing whereas similar shares were 14 per cent for India and 23 per cent for Sri Lanka.

**Table 4**

**Wages and Productivity in Manufacturing Sector**

| | *Average hours worked per week* | | *Labour cost per worker in manufacturing ($ per year)* | | *Value added per worker in manufacturing ($ per year)* | | *(3) / (2)* 100* | |
|---|---|---|---|---|---|---|---|---|
| | *(1)* | | *(2)* | | *(3)* | | | |
| | *1980-84* | *1995-99* | *1980-84* | *1995-99* | *1980-84* | *1995-99* | *1980-84* | *1995-99* |
| Bangladesh | ... | 52 | 556 | 671 | 1,820 | 1,711 | 327 | 255 |
| India | 46 | ... | 1,035 | 1,192 | 2,108 | 3,118 | 204 | 262 |
| Sri Lanka | 50 | 53 | 447 | 604 | 2,067 | 3,405 | 462 | 564 |

Source: World Bank 2000.

At an aggregate level, the depreciation of the exchange rate is also likely to have strong effects on Bangladesh's export competitiveness. The crawling exchange rate policy, on the whole, was able to maintain relatively stable real effective exchange rates during the 1990s (Figure 4). The movements during the late-1990, however, suggest some appreciation indicating the need to adopt a more flexible exchange rate management system.

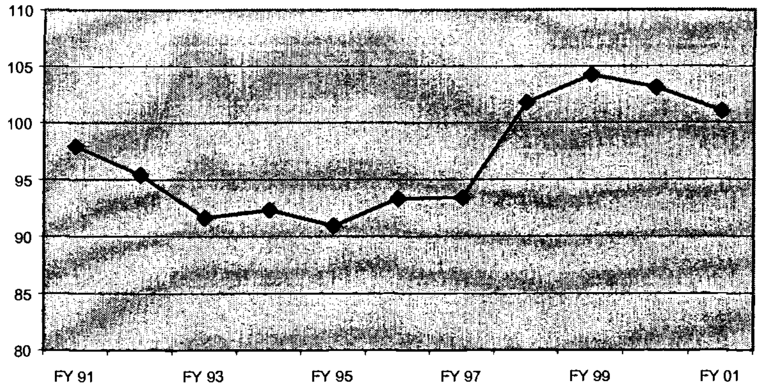
## 2.3 Remittances, Foreign Direct Investment and Aid Flows

Remittances from the overseas workers have become a major source of strength in the country's balance of payments. In US dollar terms, remittances increased to nearly 2 billion in 2000 from 0.4 billion in 1982 growing at over 5.5 per cent per annum in the 1990s. As a share of GDP, remittances accounted for more than 4 per cent in 2000 compared with only 1.4 per cent in 1980 (Figure 5).

[6] The conclusions regarding relative efficiency of a particular country from these figures need to be interpreted with caution since heterogeneity of sectors in terms of wage and productivity levels, variation in product quality, nature of production pattern and organization, and other factors affect the macro-outcomes. For deriving more meaningful conclusion, productivity calculations at the micro-level are necessary.

Figure 4: Real Effective Exchange Rate

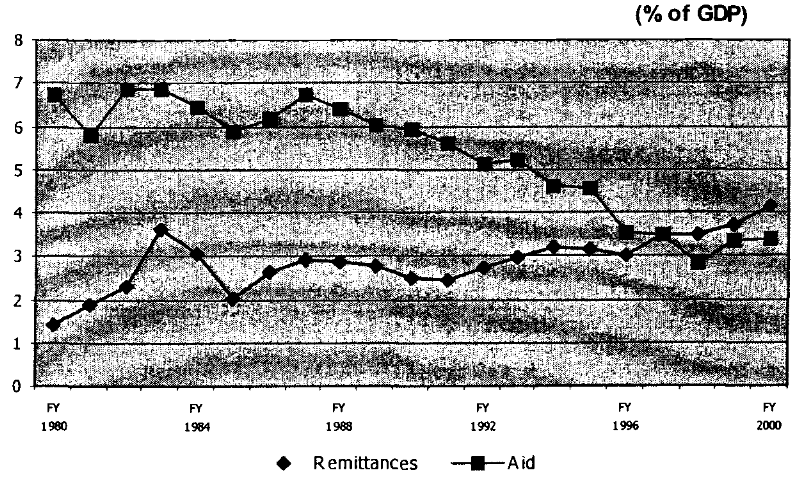
(1990 = 100)




Source: MOF 2001

Figure 5: Importance of Remittances and Aid

(% of GDP)




Sources: MOF 2001, BBS 2001

The level and pace of flow of foreign direct investment (FDI) has been low (Table 5). Foreign investment in the Export Processing Zones (EPZs) accounted for less than 10 per cent of total manufacturing investment in the 1990s (Figure 6). The bulk of the investments in EPZs went into garments, textiles, footwear and other labour-intensive industries with little in high-tech industries. The FDI outside the EPZs went mostly into gas and power sub-sectors. On the average, actual FDI flows into Bangladesh was only 0.03 per cent of GDP in the 1990s, much less than comparable figures in South Asia and other developing regions.

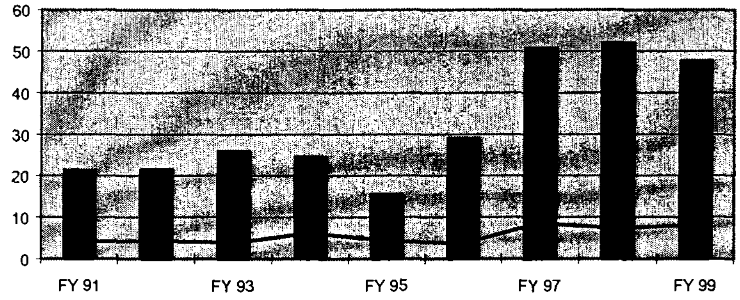
**Table 5**
**Net Foreign Investment in Bangladesh**

(Million US $)

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|---|
| Direct Investment | 7 | 16 | 6 | 7 | 16 | 249 | 198 | 194 |
| Portfolio investment | 9 | 53 | 61 | -21 | -132 | 3 | -6 | 0 |
| Investments in EPZs | 22 | 37 | 36 | 31 | 54 | 69 | 72 | 35 |

Source: MOF 2001 and BEPZA.

**Figure 6: Flow of FDI in EPZs**

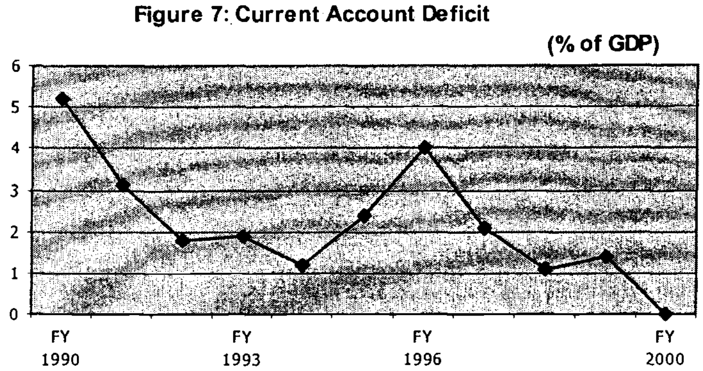



Source: BEPZA

The country's reliance on foreign aid flows is reflected in the fact that, between 1972 and 2000, the total disbursement of foreign aid was more than US $ 36 billion of which 52 per cent were loans and the rest grants. As a share of GDP, however, foreign aid has been declining rapidly. In 1980, the share was nearly 7 per cent which declined to around 3 per cent in 2000 (Figure 5).[7] The current account deficit remained below 2.5 per cent of GDP on average during the 1990s (Figure 7).

**Figure 7: Current Account Deficit**

**(% of GDP)**




Sources: MOF 2001, BBS 2001

[7] One may, however, argue that the decline in the importance of aid as a percentage of GDP has not been matched by a similar decline in the country's dependence on the donors in the arena of policy and economic management.

## 3. Trade Policy Reforms and Global Integration

During the last three decades, economic reforms have brought significant liberalization of external trade and foreign exchange regimes. Both tariff and non-tariff barriers were dismantled. During 1978, there were 36 different tariff rates extending to 400 per cent along with widespread quantitative restrictions. The reforms aimed to rationalize and simplify the trade regime by lowering tariff rates, phasing out quantitative restrictions, streamlining import procedures and introducing tax reforms. Several major changes can be noted:

(i) The highest customs duty rate was reduced from 350 per cent in 1992 to 37.5 per cent in 2000. The mean tariff declined to 22 per cent in 1999 from 114 per cent in 1989 while weighted mean tariff declined to 19 per cent from 114 per cent[8];

(ii) Four slabs of duty rates were introduced in 2000 in place of 24 in the 1980s;

(iii) The number of commodities under the four-digit code subject to quantitative restrictions declined from 550 in 1987 to 124 under the Import Policy of 1997-2002. In 1992, about 12 per cent of around 10,000 tariff lines were subject to restrictions which declined to less than 4 per cent in 1999. At present, less than 0.5 per cent of imports, mainly in the textile category, are subject to quantitative restrictions; and

(iv) Tariff bands were narrowed down and import procedures simplified.

As a result, the mean tariff rates in Bangladesh now compare quite favourably with those in other South Asian countries e.g. India and Sri Lanka (Table 6). One important point may, however, be noted: Bangladesh's reduction in the tariff rates has been the fastest between 1989 and 1999 indicating that Bangladesh liberalized its economy at a much rapid rate compared with its neighbours.

Different export promotion measures were also adopted to diversify the export base, improve export quality and stimulate higher value added exports, and develop backward linkage industries.[9] In order to liberalize the foreign exchange market, the policy of multiple

[8] However, in addition to customs duty, several taxes (e.g. value added tax, supplementary duty etc.) are levied upon imports which raises the average expost tariff.

[9] The support system is, however, highly complex, fragmented and consists of wide range of measures applying in specific circumstances. Several measures may be noted e.g. special bonded warehouses, export processing zones, duty drawback, rebate on insurance premiums, income tax rebate, export credit guarantee, incentive for export of non-traditional industrial products, export promotion fund, VAT refunds, tax holiday, and retaining foreign exchange from export earnings.

exchange rate system was replaced by a unified exchange rate in 1992 and the domestic currency (Taka) was pegged to a currency-weighted basket. A policy of creeping devaluation has been followed to maintain exchange rate flexibility and export competitiveness within a more market-determined exchange rate regime. The currency (Taka) was made convertible for all current account transactions.

**Table 6**
**Changes in Tariff Barriers**

(Per cent)

| | *Bangladesh* | | *India* | | *Sri Lanka* | |
|---|---|---|---|---|---|---|
| | ***1989*** | ***1999*** | ***1990*** | ***1999*** | ***1990*** | ***1997*** |
| **A. All products** | | | | | | |
| Mean tariff | 114.0 | 22.1 | 81.8 | 32.9 | 28.3 | 20.0 |
| Standard deviation of tariff rates | 84.9 | 14.6 | 39.4 | 12.7 | 25.5 | 15.4 |
| Weighted mean tariff | 114.2 | 19.0 | 83.0 | 27.6 | 24.1 | 20.7 |
| **B. Primary products** | | | | | | |
| Mean tariff | 85.1 | 21.1 | 74.1 | 28.8 | 31.4 | 23.8 |
| Standard deviation of tariff rates | 58.7 | 13.1 | 38.4 | 21.7 | 28.7 | 23.0 |
| Weighted mean tariff | 76.1 | 21.0 | 49.5 | 25.9 | 30.2 | 23.6 |
| **C. Manufactured products** | | | | | | |
| Mean tariff | 123.2 | 22.4 | 84.1 | 34.2 | 27.5 | 19.1 |
| Standard deviation of tariff rates | 89.8 | 15.0 | 39.4 | 8.0 | 24.5 | 12.6 |
| Weighted mean tariff | 125.5 | 18.5 | 93.6 | 28.0 | 22.2 | 19.8 |

Source: World Bank 1999, 2000.

As a result, Bangladesh's global economic integration increased rapidly during the 1990s. While the increased share of foreign trade in GDP has been mentioned, two additional measures of global integration may also be noted: (i) importance of trade; and (ii) importance of private capital flows. For these indicators, the importance of trade is measured by trade in goods as shares of both PPP GDP and goods GDP and the dynamism of trade regime is estimated by the difference in growth in real trade and growth in real GDP. For private capital flows, the measures are gross private capital flows and gross foreign direct investment as share of PPP GDP.[10] The values for Bangladesh and three other South Asian

[10] The trade in goods as a share of PPP GDP is the sum of merchandise exports and imports measured in current US dollars divided by the value of GDP converted to international dollars using purchasing power parity (PPP) rates. The trade in goods as a share of goods GDP is the sum of merchandise export and imports divided by the value of GDP less value added in services (all in current US dollars). The growth in real trade less growth in real GDP is the difference between annual growth in trade in goods and services and annual growth in GDP using constant price series. Gross private capital flows are the sum of absolute values of direct, portfolio and other investment inflows and outflows recorded in the balance of payments financial account excluding changes in assets and liabilities of monetary authorities and general government. Gross foreign direct investment is the sum of absolute values of inflows and outflows of foreign direct investment recorded in the balance of payments financial account. It includes equity capital, reinvestment of earnings, other long term capital and short term capital. For details see World Bank 2000.

countries – India, Pakistan and Sri Lanka – are given in Table 7. These indicate that: (i) though the integration of the Bangladesh economy with the rest of the world is less compared with the average for low income countries, it compares favourably with the South Asian average; (ii) the trade related indicators, in particular, suggest rapid global economic integration of the Bangladesh economy; and (iii) Bangladesh's trade regime showed more dynamism compared with India, Pakistan and Sri Lanka.

**Table 7**
**Bangladesh's Global Integration: A South Asian Perspective**

| | *Trade related indicators* | | | | | *Capital flow related indicators* | | | |
|---|---|---|---|---|---|---|---|---|---|
| | *Trade in goods as % of* | | | | *Dynamism of trade regime* | *As % of PP GDP* | | | |
| | *PPP GDP* | | *Goods GDP* | | | *Gross private capital flows* | | *Gross foreign direct investment* | |
| | *1988* | *1998* | *1988* | *1998* | *1988-1998* | *1988* | *1998* | *1988* | *1998* |
| Bangladesh | 4.2 | 7.0 | 29.9 | 56.1 | 7.2 | 0.3 | 0.8 | 0.0 | 0.2 |
| India | 3.3 | 3.9 | 18.2 | 33.6 | 4.5 | 0.2 | 0.9 | 0.0 | 0.1 |
| Pakistan | 9.3 | 8.2 | 54.8 | 53.4 | 0.1 | 0.7 | 1.6 | 0.2 | 0.3 |
| Sri Lanka | 11.5 | 17.9 | 88.0 | 118.8 | 2.9 | 2.1 | 1.8 | 0.2 | 0.4 |
| South Asia | 4.2 | 4.8 | 24.2 | 40.5 | ... | 0.3 | 0.9 | 0.0 | 0.1 |
| Low income countries | 6.8 | 8.3 | 38.6 | 62.5 | ... | 0.7 | 2.0 | 0.2 | 0.9 |

Note: For explanations, see footnote 10.
Source: World Bank 2000.

### 3.1 Impact on Economic Growth

In this section, we shall focus on examining the empirical validity of one important proposition: Has trade reforms raised Bangladesh's overall rate of growth?[11] Although strong theoretical links between trade reforms (e.g. trade liberalization) and growth have been suggested, the empirical literature on the issue is divided.[12]

The real rate of growth of the Bangladesh economy since the early 1980s is given in Table 8. The average rate of GDP growth has been higher during the post-reform period compared with the earlier years. However, this does not indicate that the trade reforms alone

[11] There exist several other routes through which trade reforms can affect the domestic economy e.g. through impact on domestic prices and changing the volatility to external shocks. Although such impacts could be significant, these are not discussed in the present paper.

[12] The theoretical models of endogenous growth suggest positive association between openness and growth through several channels e.g. embodied technology, availability of inputs, technical assistance and learning, and reduced networking costs. See Grossman and Helpman 1991, Obstfeld and Rogoff 1996. For evidence on positive relationship, see Greenaway et. al. 1998, Edwards 1998, Frankel and Romer 1999. For a strong critique of positive relationship, see Harrison 1996, Harrison and Hanson 1999.

contributed to higher growth since many other reforms were also implemented during the period. In order to assess the growth impact of tariff reforms, the simulation results with a computable general equilibrium (CGE) model calibrated to the 1995/96 SAM data base may be mentioned.[13] The preliminary results of simulation with complete elimination of tariffs (while retaining all other parameter values as in the base run) indicate that real GDP growth increases by only 2.4 per cent compared with the base run. Resources largely move to unprotected sectors (e.g. agriculture and services) from protected manufacturing activities contributing to higher growth of agriculture and services. Within the manufacturing sector, resource re-allocations take place from relatively protected to export-oriented industries. In case of distribution of gains, urban households receive higher benefits than rural households and relatively well-off households (e.g. professional, medium-skilled and large farmer households) gain more than poorer households. The results indicate that the gains from tariff liberalization are relatively small in Bangladesh and its distributional impacts differ across various groups. Since such reforms involve realignment of resources from the more protected industries resulting in lower labour demand (in the manufacturing sector in the case of Bangladesh), trade liberalization in Bangladesh can best be undertaken when the economy grows robustly so that employment losses as a part of needed restructuring can be offset by rapid growth in other sectors of the economy.

**Table 8**

**Growth Performance during Pre- and Post Trade Reform Periods**

(Per cent at constant 1995/96 prices)

| | *Pre-reform period* | | *Post-reform period* | |
|---|---|---|---|---|
| | ***1981-1986*** | ***1987-1991*** | ***1992-1996*** | ***1997-2000*** |
| Agriculture | 2.8 | 2.2 | 1.7 | 5.3 |
| Industry | 5.9 | 5.4 | 7.9 | 6.3 |
| Services | 3.9 | 3.4 | 4.3 | 5.0 |
| GDP | 3.8 | 3.6 | 4.6 | 5.4 |

Source: BBS 2001.

With the reasonable assumption that Bangladesh is a labour abundant country, the changes in the labour market are significant indicators of the impact of trade reforms. The employment pattern in the country is characterized by a low and declining level of formal

[13] The study is being carried out under the Micro Impacts of Macroeconomic and Adjustment Policies (MIMAP) Bangladesh Project at the Bangladesh Institute of Development Studies. For details see Khondker and Mujeri (forthcoming).

sector employment (in 1996, the share of private informal sector was 87 per cent of total employed population over 15 years of age). Moreover, assuming that technology and other factors have a fairly constant impact on employment and wages, trade reforms can be associated with significant deceleration in the rates of both employment creation and wages (Table 9). In fact, manufacturing employment declined at more than 6 per cent per year. This indicates that trade reforms in the country witnessed significant adjustments in the labour market, particularly in its formal segment.

**Table 9**
**Changes in Employment and Wage Rates**

(Annual growth rate, %)

| | 1986-1991 | | | 1991-1996 | | |
|---|---|---|---|---|---|---|
| | GDP | Employment | Real Wages | GDP | Employment | Real Wages |
| Total | 4.4 | 2.8 | 2.5 | 5.3 | 1.8 | 1.3 |
| Agriculture | 2.8 | 2.2 | 3.2 | 2.2 | 0.3 | 1.9 |
| Manufacturing | 6.5 | 19.2 | 2.4 | 9.5 | -6.2 | 1.6 |

Source: BBS 1998, MOF 2001.

## 4. Recent External Sector Developments and Implications

Several recent developments in the external sector e.g. negative growth in export earnings, mounting pressure on foreign exchange reserves, and aggravation of external imbalances have largely been attributed to global economic recession and the September 2001 events in the United States. These factors no doubt contributed to deepening of recent external sector problems. This is inevitable since a more open economy exposes itself to greater vulnerability from shocks and fluctuations in the global economy. The important point to note, however, is the fact that the worsening of the situation reflects the continuation and aggravation of the external sector weaknesses which surfaced earlier. The policy response by the Government has been to take several short-term measures, mostly on an ad-hoc basis.[14] While these measures may lead to some improvements in the situation, it is important to take a longer term view of the problem and address the inherent weaknesses of the external sector. This is necessary particularly in view of the fact that (i) increased global

[14] The external sector management policies included: lowering of lending rate for exports of RMG items, frozen food, and agro-industrial products; providing refinance facility for lending for RMG exports; refixation of the exchange rate; imposition of regulatory duty on import of several non-essential products; and administrative measures e.g. enhanced enforcement of foreign exchange regulations, discouraging the use of *hundi* system for remittances by improving bank services and opening more exchange houses abroad, and increasing L/C margins on imports of selected non-essential and luxury goods.

integration of the economy requires a strengthened domestic economy to withstand the global shocks; and (ii) the performance of export oriented industries has assumed increased significance in determining Bangladesh's macroeconomic and growth performance. The weaknesses of the external sector are well known e.g. narrow export base in terms of product groups and market (e.g. nearly four-fifths of Bangladesh's total exports are concentrated in the US and EU); dominance of low value-added products; weak domestic linkages of major exports; formidable supply-side constraints; weak institutions and infrastructure; and high cost of exporting and doing business. Increasing the efficiency of the external sector, raising competitiveness of Bangladesh's exports, and pro-active initiatives to access the global opportunities are critical for Bangladesh to secure a viable external sector.[15]

**Box 1**
**External Sector Indicators: Recent Weaknesses**

Several weaknesses in the external sector, along with deterioration of macroeconomic fundamentals and overall economic situation, have considerably undermined the country's short run growth prospects. The growth rate of exports declined and the resulting setback in export oriented industries created adverse effects on other production and service sectors. The garments and knitwear industries suffered the most. Import growth decelerated resulting in lower revenue collection from import-based taxes. Although remittances increased, this may remain a temporary respite and may gradually taper off unless effective measures are put in place to attract savings repatriation through official channels. As a result, the economy is likely to experience a slower growth during the current fiscal year. Several external sector related developments can be highlighted:

i) The growth of industrial production significantly slowed down: the quantum index stood at 227 in October 2001 compared with 221 in October 2000 indicating an increase of only 2.7 per cent;
ii) Export earnings declined to US $2995 million during July-December 2001 compared with US $ 3383 million during the same period of 2000. The RMG sector was especially hard hit by weakening of the US market (which receives 45 per cent of Bangladesh's RMG exports). The RMG exports (including knitwears) declined to US $ 2290 million during July-December 2001 from US $ 2555 million during the same period of 2000. This resulted in close down of about 1,300 garment factories rendering about 0.4 million persons jobless, mostly women;
iii) Pressures on foreign exchange reserves increased sharply and the reserve was equivalent to about 1.4 months of imports at the end of November 2001.

## 4.1 Some Concluding Remarks

In Bangladesh, it is important to emphasize that trade reforms do not readily bring benefits for the economy. These reforms can be made beneficial when complemented by measures at strengthening the domestic economy, addressing structural bottlenecks, and

[15] The specific measures that are needed to meet the emerging challenges in the external sector, particularly in the export sector, are well-documented and the policy agenda, both in its short and medium term perspectives, is well articulated. See, for example, Rahman 2002.

improving the policy regimes and institutional capabilities. Moreover, desired results can be achieved if the process remains sensitive to social costs and is shaped by domestic policy regime, supported by targeted safety nets for the affected people, and guided by institutional capacity to manage the transition period. The standard argument that trade liberalization would lead to increased demand for labour, especially in the formal sector, is not tenable in Bangladesh. As we have seen, actual outcomes depend on the characteristics of labour and how the labour market operates. In particular, tradable goods production in the country does not use unskilled (or least skilled) workers as the most intensively used factor and many non-tradables (such as products and services of the informal sector) are more labour intensive than the tradables. As a result, with a segmented labour market, opening up of the economy brings benefit to a few groups having specific skills while the poor workers at the lower ends of the skill profiles remain the losers. In a situation like this, the costs of trade reforms can be minimized only when the economy grows robustly and has the ability to provide cushion to the sufferers against the shocks of the restructuring process.

For a country like Bangladesh, trade liberalization has both benefits and costs. But whether the benefits would outweigh the costs depend largely on how the country 'manages' the process to its advantage. So far, trade reforms in Bangladesh have not been adequately linked with, and shaped by, domestic realities and supported by a complementary reform agenda in other fronts. As a result, the country gained relatively little from trade reforms in the 1990s and, in many respects, the adjustment costs were magnified and differed across various groups in the society. In its fight against poverty, it is important for Bangladesh to judge trade reforms by how and to what extent the policies contribute to creating opportunity, ensuring equity, and reducing vulnerability. The future course of actions and specific measures in the external sector should be devised in the backdrop of the above imperatives. For moving forward, it is important for Bangladesh to establish an early warning and effective information system for the external sector to guard against possible slippage and prevent deterioration of the trade indicators through designing quick response to adverse developments.

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*Annex*

**Table 1**
**Bangladesh: Merchandise Exports**

(million US $)

| Month | Total exports | | | RMG exports (incl. knitwears) | | |
|---|---|---|---|---|---|---|
| | FY 2000 | FY 2001 | FY 2002 | FY 2000 | FY 2001 | FY 2002 |
| **A. Exports by Month** | | | | | | |
| July | 515 | 634 | 620 | 413 | 479 | 499 |
| August | 461 | 606 | 543 | 362 | 466 | 420 |
| September | 417 | 505 | 444 | 283 | 372 | 323 |
| October | 360 | 483 | | 252 | 337 | |
| November | 428 | 532 | | 305 | 411 | |
| December | 560 | 622 | | 443 | 490 | |
| January | 443 | 472 | | 333 | 349 | |
| February | 507 | 493 | | 399 | 378 | |
| March | 430 | 433 | | 322 | 316 | |
| April | 469 | 501 | | 347 | 374 | |
| May | 452 | 587 | | 407 | 426 | |
| June | 616 | 598 | | 463 | 460 | |

**B. Changes**

| | Total exports | | | | | RMG exports (incl. knitwears) | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | FY 2000 | FY 2001 | FY 2002 | % change FY 2001 over FY 2000 | % change FY 2002 over FY 2001 | FY 2000 | FY 2001 | FY 2002 | % change FY 2001 over FY 2000 | % change FY 2002 over FY 2001 |
| July-December | 2,741 | 3,382 | 2,995 | 23.4 | -11.4 | 2,058 | 2,555 | 2,290 | 24.1 | -10.4 |
| January-June | 3,007 | 3,084 | ... | 2.6 | ... | 2,271 | 2,303 | ... | 1.4 | ... |
| Total | 5,748 | 6,466 | ... | 12.5 | ... | 4,329 | 4,858 | ... | 12.2 | ... |

Source: Export Promotion Bureau.

**Table 2**

**Foreign Exchange Reserves**

| | Reserve (end-June) million US $ | Import equivalence months |
|---|---|---|
| FY 1990 | 520 | ... |
| FY 1991 | 880 | ... |
| FY 1992 | 1,608 | 5.47 |
| FY 1993 | 2,121 | 6.25 |
| FY 1994 | 2,765 | 7.92 |
| FY 1995 | 3,070 | 6.31 |
| FY 1996 | 2,039 | 3.52 |
| FY 1997 | 1,719 | 2.88 |
| FY 1998 | 1,739 | 2.77 |
| FY 1999 | 1,523 | 2.28 |
| FY 2000 | 1,602 | 2.29 |
| FY 2001 | 1,307 | 1.67 |

Source: MOF 2001.