Trade and Commerce in Bangladesh "Challenges Ahead"

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Addressed By: Prof. Dr. M. Monwar Hossain, Director – PRC-BD

[Summary: *The paper is an attempt to identify the major challenges faced by Bangladesh economy in the field of trade and commerce and suggest remedial measures to face the challenges. In doing so, an introduction to trade and commerce of Bangladesh in general and trade policy in particular has been presented at first. Then the existing scenario of trade and commerce in Bangladesh has been explained and challenges identified. Finally, a number of recommendations have been made to meet the challenges effectively.]*

Vision of Bangladesh

The vision of Bangladesh is to become a middle income country by 2020-21 when poverty will be drastically reduced and the people of the country will be able to meet their basic needs and development will be accelerated with ever-increasing rates of inclusive growth. In achieving the vision, trade and commerce must have a definite and important role to play.

Bangladesh Trade: Bilateral, Regional and Multilateral

The international framework for financial and economic transactions has significantly changed with the presence of various multi-lateral, regional and bi-lateral trade agreements. Bangladesh is an active member of the World Trade Organization (WTO). Moreover, it has also been pursuing liberalization through many regional free-trade agreements like South-Asian Free Trade Area (SAFTA), BIMSTEC (comprising Bangladesh, India, Myanmar, Sri Lanka and Thailand, including new members-Nepal and Bhutan), Free Trade Agreement and the Asia Pacific Trade Agreement (APTA). Bangladesh has also signed Preferential Trade Agreement with D-8 member countries. It is expected that all these RTAs will facilitate foreign investment and industrial relocation in Bangladesh. One of the objectives behind pursuing trade through these RTAs is to attract more foreign and local investment in the export oriented industries of the country.

Trade Policy of Bangladesh

Bangladesh launched a deep and wide-ranging trade reform strategy in the early 1990s. This included substantial reduction and rationalization of tariffs, removal of quantitative restrictions, move from multiple to a unified exchange rate system, convertible current account and an overall outward orientation of trade policy regime. Despite apprehensions that Bangladesh might lose out to exporters from China and India following the phase-out of the MFA quotas, its share in global apparel and textile exports has remained stable and export volumes have continued their robust growth. The country's main markets are the EU and the United States and its imports are dominated in general by machinery and textiles, with China and India being the most important sources of imports. Bangladesh also has substantial unrecorded trade with its neighbor India. Labor exports are also important, with remittance in flows at about 9% of GDP.

The role of private sector driven export growth and diversification has been emphasized in Bangladesh's trade policy, making export-led growth a key thrust of its poverty reduction and growth strategies.

Tariffs and Quantitative Restrictions

Historically, like many other developing countries Bangladesh relied on tariffs and quantitative restrictions to protect domestic activities and raise revenue. Roughly 40% of its total tax revenue still comes from import taxes. Average protective tariffs are currently at 20.1%, with average agricultural tariff at 28.8% and non-agricultural tariff at 18.5%. A noteworthy feature of the present tariff structure is the significant application of para-tariff called supplementary duties, which account for about 31% of the average protection. The average customs duty, which registers a decrease over time, is currently 13.8% with four non-zero duty slabs of 3%, 7%, 12% and 25%. Food stuff, fertilizer, seed, plastic trays used in poultry and dairy, medicines and raw cottons are not subject to any custom duty. Some consumer goods, mainly the non-food luxury items, have high protective rates even up to 463%- well beyond the top custom duty rate.

Investment Incentives

In order to encourage the inflows of FDI the government of Bangladesh offers one of the most liberal investment policies and attractive packages of fiscal, financial and other incentives to foreign entrepreneurs in South Asia. Major incentives to stimulate private sector direct investment are listed below:

Tax exemptions: Generally five to seven years' tax exemptions are available for many business investments. However, for electric power generation tax exemptions are provided for up to 15 years.

Duty: No import duty is applicable for export oriented industry. For other industries it is 5% ad valorem.

Income tax: Double taxation can be avoided in most cases as the country (Bangladesh) benefits from many bilateral investment agreements. Exemptions of income tax up to three years for the expatriate employees in industries are specified in the relevant schedules of the income tax ordinance.

Remittances: Facilities for full repatriation of invested capital, profits and dividends are the norm in most situations.

Exit: An investor can wind up an investment either through a decision of an annual or extraordinary general meeting. Once a foreign investor completes the formalities to exit the country, he or she can repatriate the net proceeds after securing proper authorization from the central bank (Bangladesh Bank).

Ownership: Foreign investors can set up ventures, either wholly owned or in joint collaboration, with local partners.

Investing in the stock market: Foreign investors are allowed to participate in initial primary offerings (IPOs) without any regulatory restrictions. Also, incomes from dividends are tax-exempt for investors.

Macroeconomic Performance in Trade and Commerce

Positive Development

As a result of some of these pragmatic policies relating to trade and commerce, the macroeconomic performance of Bangladesh economy in recent years has been excellent. The GDP growth rate has been high, commodity as well as manpower export increased, remittance grew, ADP implementation became more satisfactory and collection of tax revenue strengthened.

Negative Development

In spite of some of the positive achievements relating to a number of important macroeconomic performance indicators, a number of negative developments in general and business, industry, trade and commerce in particular are being observed from the beginning of FY 2011-12. These include:

- Pressure on balance of payments
- Slowdown in export growth
- High growth of import payments
- Rise in bank borrowings
- High inflationary pressure
- Depreciation in value of BDT
- Increased burden of subsidies
- Collapse of the capital market
- Lower utilization of foreign aid
- Lower rate of non-tax revenue collection
- Low Foreign Exchange Reserve
- Higher unplanned and unproductive public expenditure

In fact, sustained moderately high growth with macroeconomic stability, which was the characteristics of Bangladesh's economic performance during the last decade, came under serious threat as the economy moved towards FY2011-12.

While a number of these developments are new, some of the others have been carried from the past only to have had aggravated in the process with the passage of time.

The Challenges Ahead and Recommendations

These disturbing developments in the economy are really alarming and demand formulation and adoption of pragmatic policies in the country's macroeconomic management to arrest the unfavorable situation. Hence, the following recommendations are made to meet the challenges identified in order to resolve the burning economic issues faced by the country currently and those likely to emerge in near future:

Reduce Pressure on Balance of Payment

Balance of Payments situation came under increasing pressure in FY2010-11. Current account balance experienced significant deterioration mainly because of the negative trade balance component with a deficit of USD2.2 billion, and imports outpaced the robust export. Trade balance stood at negative (-) USD7,328 million as against a negative balance of (-) USD5,155 million in FY2009-10. Financial account also recorded significant deficit of (-) USD1,584 million against a deficit of (-) USD651 million in FY2009-10. This was driven by lower FDI inflow (USD768 million as against USD913 million in FY2009-10) and reduction in net aid flow (USD312 million against USD902 million in FY2009-10). As a result, a deficit to the tune of (-) USD635 million was recorded in the overall balance, deteriorating from a surplus of USD2,865 million recorded in FY2009-10. The emergent BoP situation further necessitated the need to improve remittance flow and secure foreign financing to meet rising investment demand.

Check Slow Down of Exports

The extraordinary high export growth observed in FY2010-11 started to slow down in the first quarter of FY2011-12, though the pace of growth is ahead of the target set for the current fiscal year. During the first quarter of FY2011-12, Bangladesh's export to Turkey decreased by (-0.4) per cent. Given the fact that Turkey is the fourth largest export destination for Bangladeshi products, there is a need for renewed attention to this particularly important export destination. It is important to note that, export to US, the second largest export destination for Bangladeshi products, decreased by (-)1.7 per cent during the first three months of FY2011-12 when export of RMG declined by (-)0.8 per cent and that of non-RMG declined by (-)12.4 per cent. Bangladesh needs to analyze the impacts of these developments taking place at the global level and formulate appropriate strategies to deal with attendant concerns.

Control Unproductive Imports

While the export earnings started to peak, demand for raw materials, capital machineries and fuel rose dramatically resulting in higher growth of import (41.9 per cent) in FY2010-11. The high import growth overshadowed the robust export sector performance resulting in a deterioration of the trade balance. This also put the BoP situation under pressure. Hence import should be limited to necessary raw materials and capital machineries for industries and restriction must be imposed on all unnecessary imports.

Increase Foreign Currency Reserves

With dwindling reserves, FY 2012 will probably be a tough year to handle on the part of the present Government. The oil bill jumped from US $3 billion to US $7 billion impacting on the foreign currency reserves. Higher disbursement of foreign aid, greater inflow of export revenue and remittance income by expatriate workers can improve the situation.

Reduce Bank Borrowing

An important destabilizing factor for public finance in the current fiscal year is likely to be the high bank borrowing by the government. This issue has emerged as a significant problem for macroeconomic management in FY2010-11. As high as 81.2 percent of the fiscal deficit of FY2010-11 was financed through bank borrowing. If mitigating steps are not taken, this trend is apprehended to be heightened further in the current fiscal year. The government should seek to meet its incremental borrowing need from non-banking sources by increasing the sale of national saving instruments through increasing their yield rates.

In addition to this:

- The Bangladesh Bank (BB) must be fully empowered to refuse the government loans that cannot be repaid within a specific time frame.
- The state owned banks (NCBs) need to be instructed to stop giving loans to the government for unproductive purposes.
- It must be considered that the funds used by the government from the NCBs have had a negative impact on the loan giving operation for the private sector. This in turn has affected the industrial expansion and agricultural credit so vital for our food production, procurement and processing.
- The government needs to tighten its belt and stop all forms of unproductive expenditure. It should be noted that the governments' practice of issuing government bonds against such loans is tantamount to an unhealthy practice of paper transfer only.
- BB's role as a supervisor of the entire banking sector needs to be further strengthened. The non-performing banks need to be merged voluntarily with the better banks. The capital adequacy requirements need to be strictly monitored.

Bank Automation: BB's supervisory role can be strengthened when its monitoring capacity is enhanced. This is possible if technology is used in large-scale with automation in all banks made mandatory.

Reporting System: The reports and returns can be consolidated by individual bank and passed on to the BB electronically. The unnecessary use of paper can be reduced to the minimum.

Enhanced Efficiency: Every aspect of bank operations needs automation to enhance efficiency and productivity. Adequate high class banking software is available for this purpose.

Increase Workers Migration: New avenues are required to be explored so that our surplus manpower can be gainfully employed in unexplored markets. The Malaysian government's kind gesture has enabled our illegal migrant workers to be regularized. The Arab Spring uprising in the Middle East has forced several thousand Bangladeshi workers to return home. These workers have been financially crippled. The government needs to send them to some other destinations on urgent basis. The reduced remittances from these affected workers will be restored for the benefit of the individuals, their families and the nation as a whole if alternative markets are explored.

Skills Development: The Bangladeshi workers are intelligent but lack the necessary skills to get higher pay. Trade courses and vocational training institutes in large numbers need to be opened in every upazila with great stress on communication skill in English and Arabic. Bangladesh will emerge as a power house of skilled/semi-skilled workers that can triple the foreign exchange earnings. Public-Private Partnership (PPP) is the only solution where the government will gain to give one time grant to set up skills development centers under private initiatives.

Increase Government Revenues: Apart from the traditional government revenue sources, for example, income tax, sales tax, customs duty, VAT etc. the government revenue collection in respect of Titas gas, WASA, Land revenue, municipal taxes need to be streamlined and automated.

Stop Corrupt Practices: The theory of system loss is a disgrace and needs proper supervision to stop corrupt practices. Unauthorized lines in respect of power, gas and water need to be plugged. Leakage/system loss in respect of large scale gas users like rerolling mills is an example. The inspectors in collusion with the mill owners have resorted to such unholy alliance where the government and the nation is a net loser and the corrupt inspectors are rolling in wealth that has no relations with their salary and other known sources of income.

Local Taxes: Every municipality and union council has to be empowered to buy some local taxes however small this may be on individual basis. Collecting this can be large sum that can be used for a good cause in the locality. Every single union has well-to-do farmers and traders. These people must be persuaded to pay taxes on a voluntary basis.

NBR Initiatives: NBR's recent initiative of 'Tax Fair' needs to be organized throughout the country in every upazila, pourasaba and thana. Some incentives need to be offered so that the citizens become more conscious of their responsibility towards their country. A pro-people policy must be adopted to enhance government revenue.

Check Instability in the Capital Market

Lack of prudential management by the central bank and Security and Exchange Commission particularly in the early stages of capital market boom has contributed to instability in the capital market. The stability of the capital market must be restored with appropriate policy prescription. Although, there had been, in the recent times, some initiatives to reform the market regulation and management, none of these touched upon the basic issues relating to transparency and accountability including strengthening of the surveillance capacity of the body responsible for oversight, i.e. SEC. The demand for implementation of the recommendations of the Probe Committee has now become a far cry.

Uncertain Global Shock

All economic risks are cross bordered and are by and large interdependent. Thus, Bangladesh is no less threatened from the global risks and uncertainties. Despite having an estimated growth rate of 6.7 per cent in FY2010-11, several growing downside risks arising from external economic environment are exerting added pressure on the economy. The transmission channels of the implications of global economic downturn for the Bangladesh economy are primarily mediated through trade, remittances, foreign aid and FDI. Hence, Bangladesh must be ready to absorb uncertain global shock through addressing these economic factors properly.

Control Inflation

Inflation appears to have emerged as a permanent phenomenon in the economic landscape of Bangladesh over the recent past. It has started to increase since the second quarter of FY2009-10 and continued to rise throughout FY2009-10 and FY2010-11. Inflation has to be controlled to check rise in price level to save lower and middle income groups. The Central Bank should control inflationary pressure through intervention in money market and bringing down growth of credit.

Check Fall in Value of BDT

Growing balance of payments pressure got transmitted into depreciating exchange rate during last fiscal year. The exchange rate of BDT against USD has been going down further and at a faster rate in recent months. Additionally, exchange rate management has become more difficult due to volatility in international exchange rate markets. Currently, foreign exchange reserve is maintained at around USD 10.0 billion which is equivalent to 3.6 months of import payments. Hence, there is hardly any room to use foreign exchange reserve to contain BDT's value.

Check on interest payments and public debt

Both domestic and foreign interest payments, as share of revenue budget, declined during the last two fiscal years (FY2009-10 and FY2010-11). This happened largely because interest rates were low for domestic loans during

this period. In the backdrop of much diminished flow of foreign aid, interest payment on foreign loans is eating up bulk of the inflow. Given the recent experience with public debt stock, particularly in the developed countries, Bangladesh government will be well advised not to lose the comfortable space in macroeconomic management which it currently enjoys regarding pubic debt situation.

Rationalize Subsidy Demand:

Subsidy expenditure has emerged as the core destabilizing feature of the economy. Total subsidy demand for the current fiscal year was initiallyestimated at about Tk. 22,500 crore, which is now anticipated to rise to about Tk. 47,400 crore if no price adjustments are made. If that be the case, share of subsidy expenditures may increase to 29.0 per cent instead of 12.5

per cent of the revenue budget for FY2011-12. It would imply that subsidy payments will be equivalent to 5.3 per cent of GDP. The government is left with no other viable policy choices to adjust fuel and power prices upward in a phased manner.

It needs to be emphasized here that there is a serious lack of information on both subsidy allocation and expenditure by the government. The budget documents do not provide any comprehensive subsidy estimate, other than some scattered information on agricultural subsidy allocation. Actual subsidy expenditure is also not published. Given the fact that subsidy expenditure has emerged as the core destabilizing feature of the economy, greater transparency is required in this area for the citizens to appreciate the problem.

Permission for New Banks

The subject of issuance of new bank licenses is a debatable proposition. Arguably, there is hardly any need for new banks – what the banking sector needs is strengthened oversight relating to compliance of Basel III and possibly improvement of efficiency through competition and scaling up. Bangladesh Bank has drawn up a sound set of eligibility criteria for any new banks. If new license(s) has/have to be awarded it should not be based on "political consideration", but on rigorous fulfillment of the eligibility criteria.

Utilization of Foreign Aid and ADP Allocation

Proper utilization of foreign aid and ADP allocation should be ensured to achieve targeted GDP growth and maintain economic stability.

Further Liberalization of Trade Policy

Despite the trade liberalization reforms initiated in 1990s, Bangladesh is still saddled with one of the least liberal trade policy regimes in the world. Although half of the country's GDP comes from the service sector, liberalization of this sector leading to export of services is not satisfactory yet. Bangladesh faces a more favorable market access in developed markets because of its LDC status, but is yet to fully exploit this opportunity. Cumbersome customs and border procedures and an inefficient duty drawback system, in addition to the high import duties, contributed to this outcome.

The remaining trade barriers work against the emergence of new export activities and expansion of the export activities to non-enclave areas. It is no surprise then that the export base is heavily concentrated in garments, the sector facing the most liberal import regime largely because of its access to bonded warehouse facility. RMG exports account for about 75 percent of merchandise exports. The extension of the bonded warehouse facility in 2008 to all hundred percent export-oriented sectors should help promote greater export diversification. Recent measures to liberalize the banking and Telecommunication sectors are also welcome. Future trade liberalization program needs to focus on (a) reduction in the dispersion and average level of protection, (b) promotion of services export, () reduction of the reliance on limited number of goods through diversification of exports, (d) promotion of more efficient handling of custom and border procedures, and (e) a more efficient duty drawback system.

The above analysis shows that despite some good signs, trade and commerce in Bangladesh are facing a number of challenges and several measures mentioned so far are required to be taken to effectively tackle the situation.

ANNEXURE

TABLE 1: GDP GROWTH AND SECTORAL SHARE

Sectors	Share		Growth		Incremental Share	
	FY 10	FY 11	FY 10	FY 11	FY 10	FY 11
Agricultural Sector	19.6	19.3	5.2	5.0	17.1	14.6
of which - Crops	11.0	10.9	6.1	5.0	11.1	8.3
Industry	28.9	29.3	6.5	8.2	30.8	35.4
of which – Manufacturing	17.3	17.8	6.5	9.5	18.5	24.8
Service Sector	48.1	48.1	6.5	6.6	51.1	47.9
Import Duty	3.4	3.3	1.8	4.2	1.0	2.1
Total	**100.0**	**100.0**	**6.1**	**6.7**	**100.0**	**100.0**

TABLE 2: EXPORT PERFORMANCE

Product	Growth Target for FY 2011-12	Growth in FY 2011-12 (Jul-Sep)	Growth in FY 2010-11 (Jul-Sep)	Required growth for rest of the year to attain export target
RMG	13.7	621.2	31.0	11.5
Knit	13.9	18.3	31.9	12.6
Woven	13.4	24.8	30.0	10.3
Non RMG	22.5	27.6	26.1	21.1
Raw Jute	30.0	18.7	53.8	32.1
Leather	10.0	20.0	42.2	7.2
Total	**15.6**	**22.6**	**30.0**	**13.6**

TABLE 3: BANGLADESH EXPORT GROWTH

Products	World		US		EU		Rest of the World	
	FY 12 (Jul-Sep)	FY 12 (Sep)	FY 12 (Jul-Sep)	FY 12 (Sep)	FY 12 (Jul-Sep)	FY 12 (Sep)	FY 12 (Jul-Sep)	FY 12 (Sep)
Total Export	22.6	2.4	-1.7	-15.0	29.8	2.8	32.4	17.5
RMG	21.2	-6.6	-0.8	-17.0	30.0	-0.9	30.7	-5.9
Knit	18.3	-12.3	-16.8	-37.4	25.7	-4.1	20.3	-21.1
Woven	24.8	0.5	6.0	-8.4	39.2	6.4	42.8	14.0
Non-RMG	27.6	30.1	-12.4	6.6	28.2	24.6	34.1	35.8

TABLE 4: NBR REVENUE COLLECTION

Categories	Actual Growth FY 11	Target Growth FY 12	Growth Jul-Sept
Import Duty	22.8	8.8	18.7
VAT (Import)	19.9	11.1	0.3
Supplementary Duty (Import)	28.4	10.5	26.3
VAT (Local)	28.9	15.7	11.4
Supplementary Duty (Local)	27.8	21.5	16.0
Income Tax	32.4	21.4	24.9
Others	25.9	25.0	21.5
Grand Total (NBR)	**27.2**	**16.2**	**15.2**

TABLE 5: GROWTH OF WORLD OUTPUT AND TRADE, 2005-2012

Region	2005-2008 (average)	2009	2010	2011	2012	2011	2012
World	3.3	-2.1	3.9	3.3	3.6	3.5	3.7
USA	1.9	-2.6	2.9	1.6	2.5	3.0	2.8
European Union	2.2	-4.2	1.8	1.7	1.9	1.8	1.8
South Asia	7.5	5.7	7.1	6.9	7.0	6.8	6.8
China	11.3	9.1	10.3	9.1	8.9	8.9	9.0
LDCs	7.7	4.1	4.7	5.6	5.8	5.5	5.7
World Trade in Goods and Services	7.1	-11.1	11.9	7.1	6.8	7.6	7.1

TABLE 6: SELECTED MONETARY INDICATORS

Indicator	FY2010-11	FY2011-12	% Change Sept' 11 over Sept' 10	% Change Sept' 10 over Sept' 09
Domestic Credit	3,564,987 (Sept'10)	4,499,301(Sept'11)	26.21	20.33
Credit to Public Sector	692,561 (Sept'10)	995,551 (Sept'11)	43.75	-0.28
Credit to Private Sector	2872,426 (Sept'10)	3,503,750 (Sept'11)	21.98	26.65
Broad Money	3,790,956 (Sept'10)	4,533,976 (Sept'11)	19.60	21.48
Reserve Money	824,220 (Sept'10)	970,139 (Sept'11)	17.70	10.48

TABLE 7: DEFICIT FINANCE IN FY11 AND FY12 **(Crore TK.)**

Sources of Financing	FY11 Budget	FY11 Actual	Difference (Actual and Budget FY11)	FY12 Budget
Foreign Borrowing – Net	10834.4 (31.4)	2232.5 (7.2)	-8601.9	13058.0 (32.4)
Foreign Borrowing	15968.0 (46.3)	7659.7 (24.7)	-8308.3	18685.0 (46.4)
Amortisation	-5133.6 (-14.9)	-5427.3 (-17.5)	-293.7	-5626.7 (-14.0)
Domestic Borrowing	23679.6 (68.6)	28780.8 (92.8)	5101.2	27208.0 (67.6)
Bank Borrowing (Net)	15680.0 (45.4)	25210.2 (81.3)	9530.2	18957.0 (47.1)
Non-Bank Borrowing (Net)	7999.6 (22.2)	3570.6 (11.5)	-4429.0	8250.8 (20.5)
Total Financing	34513.9 (100.0)	31013.2 (100.0)	-3500.7	40266 (100.0)

TABLE 8: SUBSIDY REQUIREMENTS IN FY12

Setor	Revised Budget FY11	Budget FY12	Revised requirements for FY12	% of total subsidy (revised requirement)
BPC	4000	3500	28014	59.1
Agriculture (fertilizer, Diesel and electricity)	5700	4500	6835	14.4
PDB	4000	5200	5200	11.0
Export	2000	2200	2200	4.6
Food	1653	1677	1736	3.7
BJMC and others	358	3400	3400	7.2
Total	17711	20477	47385	100.0
% of Budget	13.3	12.5	29.0	-
% of GDP	2.2	2.3	5.3	-

TABLE 9: AID UTILISATION BY THE TOP 10 MINISTRIES/DIVISION DURING JUL-SEP, FY12

Ministry/Division	Allocation of aid	Expenditure of aid	Rate of utilization
Bridges Division	3452	6	0.2
Roads Division	1461	14	1.0
M/O Water Resources	820	12	1.4
Energy & Mineral Res. Division	679	14	2.0
Local Govt. Division	5461	142	2.6
Power Division	2727	104	3.8
M/O Education	1503	90	6.0
M/O Primary & Mass Education	650	53	8.2
Railway Division	1245	141	11.4
M/O Health & Family Welfare	61	17	27.8
Total (10 ministries)	18059	594	3.3
Share in total ADP	39.3	3.2	

TABLE 10: SHARE OF INTEREST PAYMENTS IN TOTAL REVENUE BUDGET

	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11	FY 12
Total Interest Payment	14.3	14.0	15.0	15.7	14.6	12.1	11.0
Domestic	12.1	12.0	13.4	14.2	13.3	10.9	10.1
Foreign	2.3	2.0	1.5	1.5	1.3	1.2	0.9