



# BIDS

## *Policy Brief*

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### **Trade Policy and the Pattern of Trade in Bangladesh<sup>1</sup>**

This Policy Brief examines trade policy and pattern of trade with a view to promoting food security in Bangladesh.

#### **1. Overview**

Bangladesh's trade performance in recent years has been very impressive. Export earnings from readymade garments (RMGs) have boomed—increasing from US\$4.9 billion in FY2003 to US\$24.2 billion in FY2011, which claims major share (about 77 percent) of total export earnings. The share of trade (exports plus imports of goods and services) in the Bangladesh economy has increased significantly from about 12 percent of GDP in FY1990 to over 30 percent in FY2001, and afterwards, rather slowly, from 36.3 percent in FY2004 to 44 percent in FY2010, showing the importance of trade in the economy (Figure 1). The trade performance of Bangladesh (measured in terms of trade-GDP ratio) is now comparable to several South Asian countries like India and Sri Lanka.

It is worth noting that during 1981-2010, export intensity has made a steady progress, increasing from about 4 percent in 1981-85 to about 17 percent in 2006-10 (Figure 1). At the same time, the difference between export and import intensities has also increased. Widening of the difference between export and import intensities can be explained by the

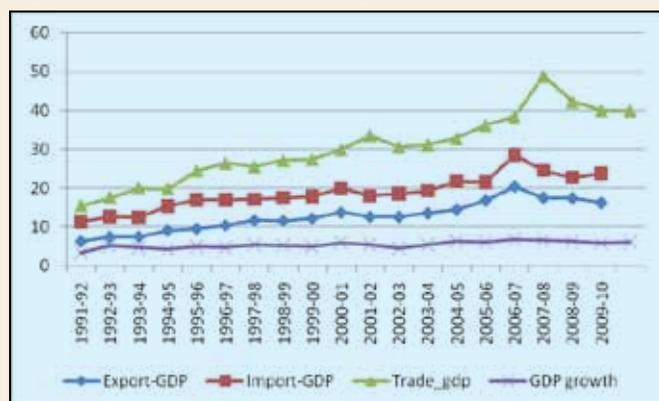
increase of import dependence as well as increased global price of imports relative to the country's exports.

For Bangladesh, an analysis of agricultural trade is important in the context of the large agrarian base of the economy. Although agricultural trade in Bangladesh dominated in the 1970s and 1980s, the share of agriculture in the overall trade volume started to decline since then, particularly when the liberalization process started. The major agricultural export was jute and jute goods, which had lost attractiveness because of fierce competition from synthetics as well as lack of proper research and development for jute and jute goods. While agriculture constituted around 21 percent of total trade in the 1980s, the share dropped to 11.1 percent in 2011. Food grain production, particularly rice production, increased threefold since Bangladesh's independence, mainly due to increased availability and affordability of agricultural inputs largely because of the import liberalization policies. This reduced the country's import dependency on food grains in recent years. Favorable trade policies also helped to maintain a good reserve of food grains to address any crisis situation.

<sup>1</sup>This policy brief is based on the study, Trade Policies and Pattern in Bangladesh, carried out by Monzur Hossain and Narayan C. Nath under the Policy Research and Strategy Support Program (PRSSP) being implemented by BIDS with support from IFPRI and USAID.



**Figure 1: Trade pattern in Bangladesh**



Source: Export Promotion Bureau, Bangladesh Bank.

## 2. Trade Liberalization Policies

The impressive trade performance of Bangladesh is largely attributed to the extensive reforms in trade policies pursued in the 1990s (Ahmed and Sattar 2004). The major objective of the trade reform was to encourage exports by reducing the anti-export bias. An account of these trade reforms is provided below.

- Various reform measures included simplification of import procedures, reduction and harmonization of tariff rates on similar products, gradual reduction of non-tariff barriers, removal of restrictions on repatriation of profit and income from foreign investment and similar measures.
- The highest customs duty rate was reduced from 350 percent in 1990 to 32.5 percent in 2003 and further to 25 percent in 2011.
- At present, most of the quantitative restrictions are applicable on non-trade grounds such as health, environment, culture, and national security.
- The number of operative tariff slabs was reduced from 24 in the 1980s to 5 in 2010, and the (un-weighted) average customs duty rate was reduced from 100 percent in 1985 to 57 percent in 2000 and further to 15 percent in 2010.
- The average un-weighted tariff rates in agriculture fell from 24 percent in 2000 to 17.6 percent in 2008. The average weighted tariff rates fell from 11.3 percent in 2000 to 5.6 percent in 2008 (Table 1).

**Table 1: Tariff structure of WTO HS agricultural category for Bangladesh**

Tariff Year	1994	2000	2005	2008
Simple Average	83.1	24	17.4	17.6
Weighted Average	50.2	11.3	7.4	5.6
Standard Deviation	40.1	13.2	9.1	8.9
Minimum Rate	15	0	0	0
Maximum Rate	300	37.5	25	25
NBR of Total Lines	773	794	1005	967
NBR of Domestic Peaks	14	0	0	0
NBR of International Peaks	746	561	594	581

Source: WITS.

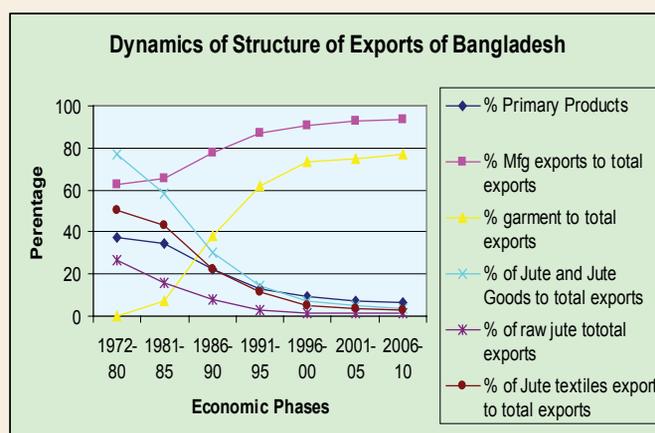
## 3. Pattern of Exports and Imports

### Characteristics of export growth

Although Bangladesh has lost its importance in the supply of jute goods, which was the main export item in the 1980s, it achieved tremendous success in knitted and woven garments export. While in the 1970s, jute and jute goods constituted about 77 percent of total exports, in the period of 2006-2010, garments constituted 77 percent (Figure 2). Thus Bangladesh has been successful to diversify its exports from agricultural products to manufactured products.

Knitted garments superseded woven garments in recent years and the share of woven garments has virtually declined from 50 percent in 1991-95 to 38 percent in 2006-10. It is worth noting that although garments have played a crucial role in the last two decades, it is concentrated mainly in five products: T-shirts and Pull over (80 percent taken together) in knitted garments and jackets, trousers and shirts (90 percent taken together) in woven garments. Thus although remarkable success has been achieved in both knitted and woven garments, exports are concentrated to only a few categories of garment products (Figure 3).

**Figure 2: Export dynamics**

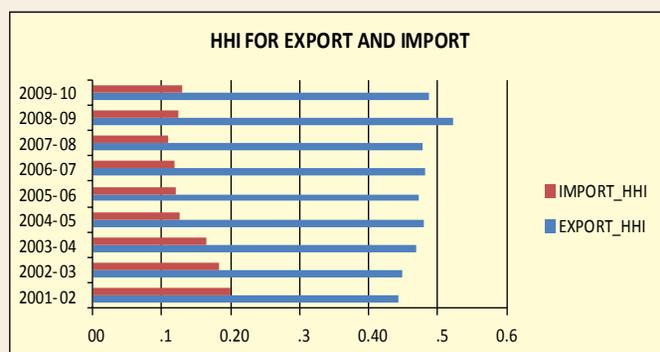


Source: Bangladesh Bank.

**Food export:** Despite a robust growth in total exports, agricultural exports, however, did not increase much. It

remained stable at 0.5 percent of total exports during the 1990s and the first half of the 2000s; however, it increased somewhat in 2006-10. The share of exports of frozen food declined in 2006-10 compared with the previous periods, mostly due to the failure to maintain compliance standards. Exports of processed agricultural products, which were relatively negligible, showed a much sharper decline in the 1990s compared with the exports of primary agricultural products. The reason of such a decline, as argued by the stakeholders, is attributable to some anomalies that exist in the case of raw material import and processed food import, which has adverse impact on export of agro-processed food products. Among other food items, export of vegetables, fruits, coffee/tea, and cereals show an increasing trend.

**Figure 3: Concentration of exports and imports, 2000-2010**



Source: *Economic Trends, Bangladesh Bank.*

**Market share of exports:** Only nine countries constitute about 75 percent share of total exports of Bangladesh during 1991-2010, which was 38 percent in 1981-85. The share of other countries has declined from 62 percent in

1981-85 to 25 percent in 2006-10. The US alone accounts for 25 percent of total exports, while three European countries, namely UK, Germany and France, together buy 25 percent of total export products. Just four markets account for 50 percent of total exports. Thus, Bangladeshi export is concentrated not only in a few commodities but also in a few markets. This suggests the need for massive drive for greater market access and diversification to avoid instability and vulnerability of exports.

#### 4. Export Promotion Policies

- Bangladesh Government has been providing cash incentives as a measure to promote and diversify non-traditional exports. Currently, cash subsidy is available for leather goods (100 percent export oriented industries), agricultural goods, frozen shrimps and other fish, vegetables and fruits, processed agro-products, bone meal, bi-cycle, commodities made of hogla, straw, coir of sugarcane, potato, eggs and day old chicks of poultry industries; liquid glucose produced at Iswardi EPZ; light engineering products and halal meat. Various rates of incentives are applicable, which are subject to change over time. Although the value of exports of these products has been increasing, their relative share has been declining with increased share of garment products.
- Although total export has doubled between 2002 and 2008, the ratio of cash subsidy to total exports remained almost the same throughout the period. The benefit as a ratio of promoted exports is nearly 2 percent over



the years, which appears to be insufficient to influence export performance. Econometric results suggest that the impact of cash incentive is insignificant for promotion of total exports.

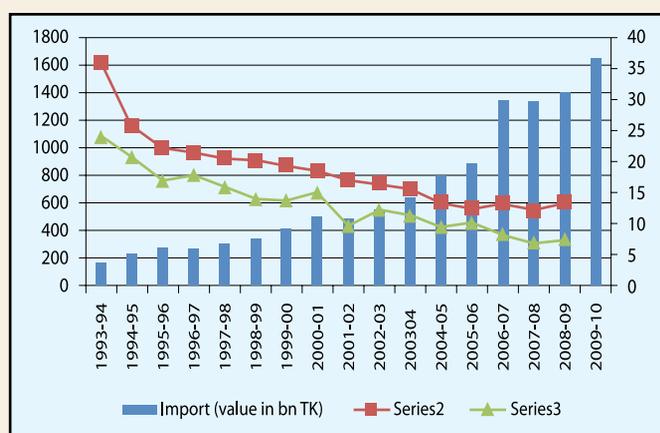
- The coefficient of real effective exchange rate (REER) volatility, with a low magnitude, is positive and significant on exports, implying that a stable exchange rate makes a positive impact on exports.

### Characteristics of Imports

The composition of imports has changed over time. The share of consumption goods increased from 31 percent in 1981-85 to 57 percent in 2006-10. Next important item of import is intermediate goods constituting about 22 percent in recent years. Its share was 23.3 percent in 1981-85. The share of primary goods has substantially declined from 28 percent in 1981-85 to 14 percent in 2006-10. The share of capital goods has also substantially declined to 7 percent from 30 percent in 1981-85 (Figure 4).

In terms of growth, there has been no stable growth of capital machinery and primary goods. The growth of consumption goods is predominantly high, followed by intermediate goods. Growth of all categories of imports was high in the 2001-05 period. The growth rate declined from 33 percent in 1981-85 to 11 percent in 2006-10. The growth rate of intermediate goods has risen, while that of capital machinery has declined during the same period, particularly due to political crisis in Bangladesh combined with global economic downturn during 2008-2009.

**Figure 4: Impact of tariff reduction on imports**



Note: Import values are expressed in billion Taka; tariff rates are presented in percent.

**Market share of imports:** Imports of Bangladesh are concentrated in nine countries constituting about 63 percent of total imports. Two suppliers, India and China, together constitute one third of imports of Bangladesh. While India and China constituted only 6.2 percent in 1986-90, they have come up with increasingly greater share in the market

of Bangladesh. The share of imports from other countries has sharply declined from 59 percent to 37.5 percent during the period.

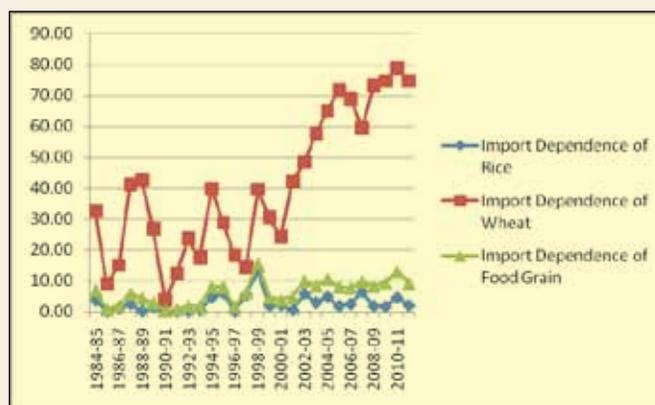
## 5. Trade Balance and Import Coverage Ratio

One of the important trade performance indicators is trade balance. Its ratio with GDP would give reflection about dependence for development on foreign aid or external income other than exports of goods. Data suggest that every year the government has been incurring trade deficit of around 7,500 million dollars. Trade deficit has increased from 1,733 million dollars in 1981-85 to 7,486 million dollars in 2006-2010 i.e. increased by 27.5 percent. Average annual growth of trade deficit has increased considerably in 2001-05 and 2006-10 periods as compared with the negative growth rate in the 1996-2000 period. It is notable that the proportion of trade balance to GDP hovers around 7 percent in all periods. Corresponding to this, import coverage ratio (value of import as a percentage of export) has increased significantly from 31 percent in 1981-85 to 66 percent in 2006-2010.

## 6. Agricultural Trade and Food Security

Import dependence on rice has decreased substantially over time, due to near self-sufficiency in rice production achieved in recent years. However, import dependence on wheat is quite substantial (about 77 percent in FY2011), increasing from 28 percent in 1985-90. While rice production has increased remarkably over the years, wheat production has fluctuated with a declining trend. The ratio of food grain imports to total supply of food grains increased from 3.7 percent in 1985-90 to 11 percent in FY2011.

**Figure 5: Import dependency of food grains**



Source: BBS and Ministry of Food.



### Agricultural trade liberalization pays off

In line with trade liberalization, import of food grains has also been liberalized substantially, which has made a positive contribution to food imports and food security. In the case of rice, maize, and soya bean oils, import tariffs have been brought down to zero in recent years to meet the growing demand and address international price volatility. Bangladesh has been a consistent net importer of food grains over the past decades. The major source of import during the 1980s and early 1990s was Thailand. However, the trade liberalization that permitted private sector imports coincided with India's rice trade liberalization which dramatically changed the source of rice import, with India emerging as the major exporter of rice to Bangladesh (Box 1).

All quantitative restrictions on agricultural products have been removed in the 1990s. Tariff lines of all products that faced quantitative restrictions were brought down to only 2 percent in 1994, and zero in subsequent years. Private sector imports of rice and wheat were allowed in the early 1990s, ending the government's monopoly on food grain imports. The ban on rice export of fine quality rice (but not on exports of coarse rice) was also lifted. These liberalization policies have impacted positively on the growth of import volumes (Ahmed et al. 2007).

As rice is the main staple food, nominal rate of protection of rice has been estimated for the period 1975-2011. It has been observed that up to 2001, the nominal rate of protection was negative, but after 2001, it was positive. In the 2000s, rice market experienced some turmoil, as the big exporters like India and Thailand imposed ban on rice exports in 2007-08. The domestic price some times becomes lower than

the world price due to costs of transport, insurance, time of delivery and uncertainty of marketing the imported rice. Besides, government intervention for price stabilisation tends to keep the domestic price low. Thus, public food grain distribution, stock management and subsidies need to be aligned properly for maintaining smooth food supply.

### BOX 1: Agricultural input liberalization policies

During the mid-1980s through the mid-1990s, agricultural input markets in Bangladesh were substantially liberalized. Reforms have been quite extensive in the areas of fertilizer marketing, privatization and deregulation of minor irrigation, and seed development and marketing (Dowla 2001).

**Fertilizer:** The fertilizer sector, which played a crucial role along with modern high-yielding varieties in tripling rice production in Bangladesh, went through some fundamental reforms. Up to the early 1980s, fertilizer production and marketing was controlled by the Bangladesh Agricultural Development Corporation (BADC); however, by the late 1980s, BADC withdrew its control, and an elaborate network of private sector companies took over the fertilizer marketing operation.

**Irrigation:** Extensive policy reforms were also carried out in the area of minor irrigation since the late 1980s. The ban on imports of small engines was lifted, and all import duties on irrigation equipment were removed. Regulations on engine standardization as well as spacing of wells were also withdrawn. As a result, a robust private economy now operates in the minor irrigation sector, which has not only brought down prices for irrigation equipment but also contributed to a substantial increase in irrigated area. Minor irrigation played a crucial role in the expansion of irrigation area as more than 80 percent of irrigation now takes place through this mode.

Liberalization of agricultural inputs has made a positive and significant impact on food grain production, particularly of rice. Production of other crops, such as vegetables and non-rice winter crops, has grown at slower rates due to many factors, including land constraints, problems of transport and marketing, and the non-availability of improved seeds.

*Source: World Bank 1999, pp. 11–13.*



## 7. Trade Potentials and Market Opportunities

Estimated revealed comparative advantage (RCA) shows that Bangladesh has been enjoying high revealed comparative advantage in knitted garments, woven garments, jute and jute goods, other textile articles, frozen fish, leather, footwear, headgear and parts. Trade specialization index of these products is on average around 0.75. But these product categories are facing high concentration in terms not only of products (88 percent share for three products) but also of market destinations (55 percent for three markets). At the same time, traditional export commodities including tea and leather have lost their previous comparative advantage.

The sectors which exhibited dynamism are footwear, ceramic products, household articles including tableware and kitchenware, light engineering, pharmaceuticals, bicycles, tent, home textiles and vegetables. These results indicate that attention needs to be given not only on revealed comparative advantage of products for specialization, but also on diversification of export items and market destinations. This is important for ensuring sustainability of export earnings on a long term basis.

**Potential trade markets:** The Trade Potential Index indicates that for Bangladesh a large number of products have huge potential for trade in a number of countries. In terms of the number of items with very high trade potential, India ranks in the first place; countries like Italy, Germany, Australia, Spain and China are also very potential markets for a number of products. The other promising markets where Bangladeshi exporters can explore in future are Austria and

Turkey. However, to get access to these promising markets, products of high quality need to be maintained in line with sanitary and phyto-sanitary restrictions in these countries. For this purpose, necessary institutions and expertise need to be developed.

## 8. Policy Implications

- Diversification of export commodities is definitely a possible option to pursue. There have been huge potentials for trade for Bangladesh in markets like India, China, Australia, Italy, Germany, and Spain. Although highly concentrated, the potentials of readymade garments have not yet been exhausted, rather the sector can move forward comfortably with background experience for a number of years with accumulated skill of about 5,000 entrepreneurs and about 4 million workers. Ensuring workplace safety, meeting minimum wage requirements, upgrading products into fashionable categories, and adoption of technologies could make the sector more competitive.
- In order to diversify the export basket, policies should be oriented towards stimulating productive investment, building technological capacities and strengthening linkages within and across sectors and between different enterprises. The following measures can be undertaken:
  - Strengthen national capacity to undertake analysis of competitive potential at the product and subsector level;
  - Establish the quality and conformity assessment infrastructure required to increase exports. Priority should be given on strengthening the Bangladesh Standard and Testing Institute (BSTI).
  - Provide special attention to productive sectors with high export potential to upgrade product and



production quality and comply with standards and regulations so that enterprises can enhance export;

- Allocate sufficient fund for research and development (R&D) of agro-processed products. In particular, build capacities of existing research institutions, such as Bangladesh Agriculture Research Institute (BARI), Bangladesh Council for Scientific and Industrial Research (BCSIR) and related organizations.
- Develop appropriate mechanism in cases where export products encounter technical barriers and advise on technical solutions to problems.
- International assistance can play an important role in eliminating barriers to trade by strengthening essential public sector capacities. An effective mechanism should be developed to utilize "Aid for Trade" for trade capacity development.
- Various studies including the current study indicate that agro-processed products have huge potential to emerge as one of the most important exporting industries of Bangladesh. Bangladesh should take up market opportunities for exporting agro-processed products under the initiative of "Everything but Arms" of EU since this provides the least developed countries (LDCs) with zero-tariff, zero-quota export facilities to the EU market.
- Cash incentive program needs to be re-evaluated in terms of value and process so that it can make a significant impact on exports. The sectors which came into export dynamism such as footwear, ceramic products, household articles including tableware and kitchenware, light engineering, pharmaceuticals, bicycle, tent, home textiles and vegetables need to be nurtured properly.
- Despite a robust growth in overall exports, agricultural exports, however, did not increase much. It remained stable at 0.5 percent of total exports during the 1990s and the first half of the 2000s; however, it showed some increase in 2006-10. A few measures are suggested below to enhance export of agro-based products to harness the export potential of this industry:
  - Special credit facility, interest and tax subsidy could be provided to agro-processed industry;
  - Cash incentives can be continued for existing agro products as well as expanded for new products;
  - Import duty should be curtailed to the minimum level in the case of import of necessary inputs such as chemicals, packaging materials, raw materials, and so on;
  - Existing anomalies in tariff structures between inputs and processed products need to be harmonized. For example, current structure of levying higher duty on raw materials and other inputs than processed products hurts the competitiveness of local products;
  - Bonded warehouse facility can be extended to agro-industries; and
  - Quality control measures must be strictly institutionalized and implemented.
- Current exchange rate management provides support to exporters, which needs to be continued. However, a more pragmatic exchange rate policy is desirable (Hossain and Ahmed 2009).





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