

# **THE EMERGING CRISIS IN BANGLADESH'S EXTERNAL SECTOR**

## **INTRODUCTION**

The recent stagnation in Bangladesh's export sector is now reaching a point where it can no longer be ignored as a transitory phenomenon. And it is perhaps also not illogical to hypothesise that the continuing departure of the export sector performance from the trend line observed during the past few months, is *not* something which will be subsequently corrected with the passage of time, and on its own. Evidently, the emerging problems confronting the sector are more deep rooted than would appear on the surface. Thus, it is not surprising that the setback being endured by the export sector is transmitting ominous signals throughout the economy, and is now a cause for serious concern to all the stakeholders in this sector.

As far as the experience of Bangladesh's external sector is concerned, FY2002 is likely to go down in the country's economic history as a watershed. The sector has been under unprecedented pressure through the first half of FY2002. For the first time in recent memory, the export sector has posted negative growth. Imports have also decelerated as a result of depressed demand of the export-oriented sectors, and the slowdown of the GDP growth rate. The balance of payments situation which registered some improvement in FY2002, compared to the deterioration in FY2001 owing to the higher growth rate of imports compared to exports, again came under pressure in recent months as export earnings continued to fall sharply. The deterioration in our Balance of Payments situation has been reflected in the decline in our foreign exchange reserves which have stagnated at the uncomfortable level of less than two months' worth of imports.

The recent crisis in the export sector can, in part, be explained by the ongoing global economic recession. As the Bangladesh economy becomes more integrated with the global economy, it also exposes itself to vulnerability from shocks and fluctuations in the global economy. As a matter of fact, the deceleration in Bangladesh's export sector began to be visible even during the second half of FY2001, which coincided with the period when the global recession first set in. Other factors joined forces to

deepen the negative trends in the external economy. In the early months of FY2002 the underlying weaknesses of the economy, compounded by formidable supply side bottlenecks, have accentuated the negative impact the global recession. This exposed the fragility of the external sector which had hitherto been viewed as an area of boundless promise.

This paper concentrates mainly on a review of the external sector performance during the first half of FY2002 (July-December). The paper traces some of the major trends in recent period and focuses on a number of emerging problems which will need to be addressed if the current downward slide is to be arrested, and the promise of the recent past is to be restored.

## **I. EMERGING TRENDS IN THE EXPORT SECTOR**

### ***When did the deceleration set in***

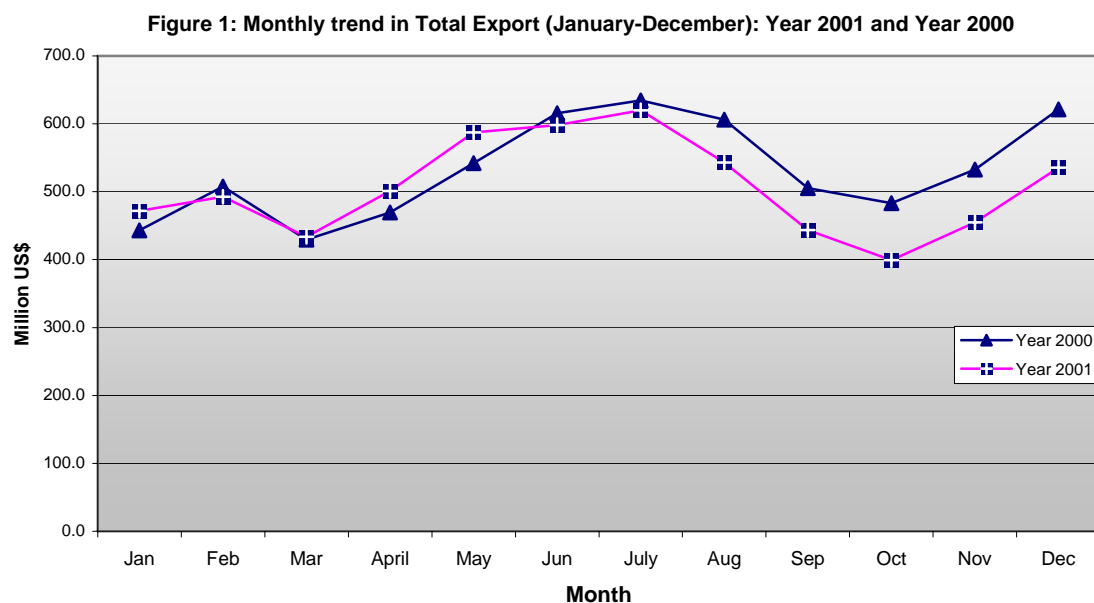
In order to identify the causes of the deceleration in export earnings it is important to identify when the declining trend first set in. The slump in export earnings started to attract serious attention when a negative growth rate was posted during the first quarter (July-September, 2001) of fiscal year 2002 (FY2002). The slowdown in exports did indeed come as a shock to many. This owed, in large measure, to the fact that the negative growth rates posted in FY2002 came in the wake of the robust 12.4% growth rate registered by the export sector in FY2001 (July'00-June'01). As a matter of fact, export earnings increased from \$5748.1 million in FY2000 to \$6467.8 million in FY2001: exports of woven-RMG had gone up by 9.1% and knit-RMG by 17.8%; earnings from export of frozen food went up by 6.1% whilst the leather sector registered an impressive growth of 29.8%.

However, a close scrutiny of the export sector dynamics during FY2001 reveals that the early signs of a slump are indeed discernible from the beginning of January 2001. Exports during the second half of FY2001 (January-June, 2001) were \$300 million below the first half of FY2001 (July-December, 2000), a most unusual phenomenon in Bangladesh's recent history. In each year in the recent past, exports have indeed picked up during the second half of the fiscal year. To contrast, in FY2000 export earnings in the second half had increased by \$263.0 million compared to the first half

of the fiscal year. Only in FY2001 do we see an overall 8.8% decline in exports during the second half of the fiscal year relative to the first half: export of woven-RMG had decreased by 11.6%, knit-RMG by 5.6%, shrimps by 40.7% and jute goods by 8.7%. Thus, the overall positive growth rates posted for the whole of FY2001 conceals the fact that deceleration had indeed set in earlier on, in January 2001.

***Export sector performance during FY2002 (July-December)***

The abovementioned slowdown during the January-June period of FY2001 was reinforced by a continuing deterioration in performance of the export sector in the early months of FY2002. This is clearly visible from Figure-1.



Export earnings during the first half of FY2002 (July-December, 2001) were only \$2995.1 million, down from the \$3383.2 million posted during the corresponding period of FY2001 (July-December, 2000), a decline of \$388.1 million in absolute term, or by 11.5%. What is alarming is that this decline has been consistent for all the six months and across all principal categories of exports. This is clearly visible from Table-1 and Figure-2. Export of primary commodities declined by about 27.1%, and that of manufactured commodities, by 10.2%.

The decline in overall growth was accounted for, to a large extent, by the fall in exports of the RMG, both woven and knit. Month for month, exports of woven-RMG declined all through the July-December period of FY2002 compared to the matched

period of FY2001 (Figure-3). Exports of woven-RMG came down from \$1785.7 million to \$1583.9 million, posting a negative growth of 11.3%. What is of no less concern is that, export performance of the knit-RMG, a sector which was able to register phenomenal growth in all years during the recent past, was no exception to the overall sorry state of affairs in the Bangladesh export sector: the sector registered a negative growth rate of 8.2% during the July-December period of FY2002 compared to the corresponding period of FY2001. As Figure-4 bears out, exports of knit-RMG were consistently below the level attained during the previous year.

**TABLE 1: STRUCTURE AND GROWTH OF EXPORTS DURING JULY-DECEMBER: FY2002 AND FY2001**

Commodities	Exports in July-December			Growth Rate	
				(in Million US\$)	
	FY 2000	FY 2001	FY 2002	FY 2001	FY 2002
Raw Jute	30.24	31.85	25.03	5.32	-21.41
Tea	9.17	15.69	10.40	71.10	-33.72
Frozen Food	168.43	225.28	157.32	33.75	-30.17
Others	18.47	18.01	19.19	-2.49	6.55
<b>Primary Commodities</b>	<b>226.31</b>	<b>290.83</b>	<b>211.94</b>	<b>28.51</b>	<b>-27.13</b>
Jute Goods	146.97	120.76	114.91	-17.83	-4.84
Leather	94.14	115.65	100.43	22.85	-13.16
Woven-RMG	1490.40	1785.69	1583.87	19.81	-11.30
Knit-RMG	589.06	769.06	706.19	30.56	-8.17
Chemical Products	41.19	55.00	36.13	33.53	-34.31
Others	152.62	246.23	241.65	61.34	-1.86
<b>All Mfg. Products</b>	<b>2514.38</b>	<b>3092.39</b>	<b>2777.50</b>	<b>22.99</b>	<b>-10.18</b>
<b>Total Exports</b>	<b>2740.69</b>	<b>3383.22</b>	<b>2995.12</b>	<b>23.44</b>	<b>-11.47</b>

Export earnings from sectors with strong domestic linkages such as raw jute, jute goods and frozen food also suffered a severe setback in the face of depressed global demand. Amongst major exportables the sharpest fall was for exports of frozen food, an important export item with multiplier linkages with the domestic economy, which declined by 30.2% (Table-1).

**Figure 2: Monthly Trends in Total Export (July-December): FY2002 and FY2001**

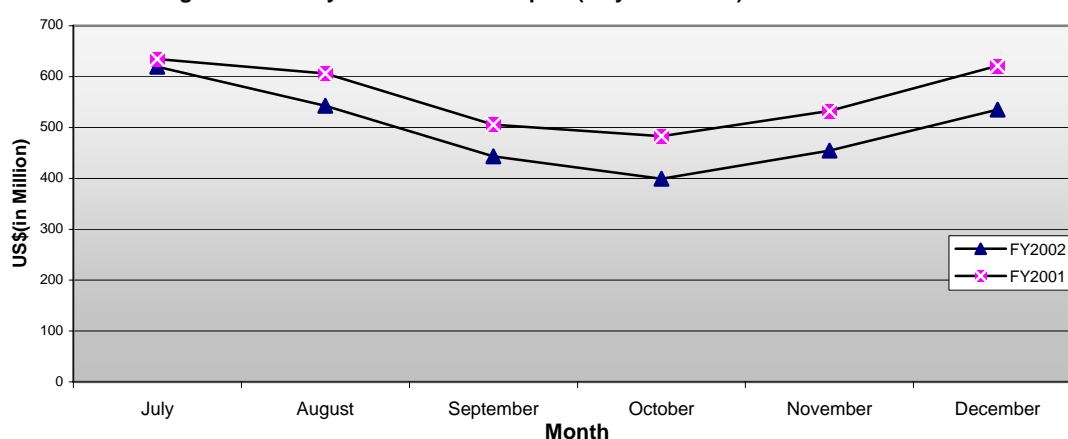


Figure 3: Monthly Trend in Woven RMG Export (July-December): FY2002 and FY2001

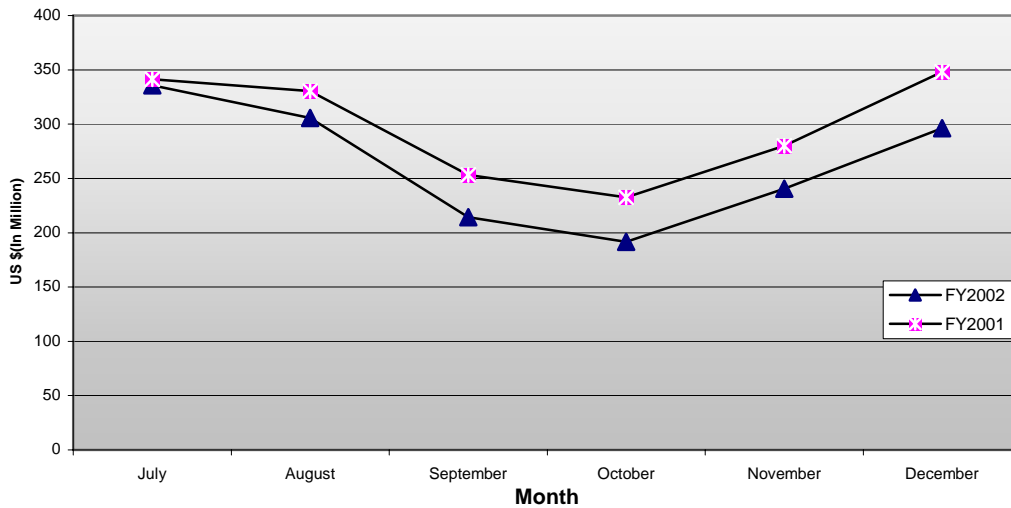


Figure 4: Monthly Trend in Knit RMG Export (July-December): FY 2002 and FY2001

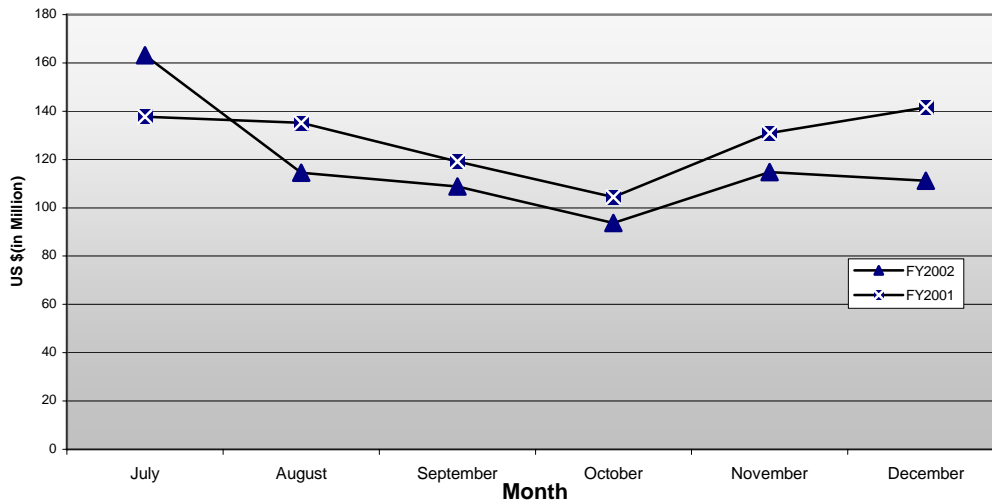


Table-2 provides an analysis of the performance of the export sector on the basis of the structure of exports, incremental exports and net exports. The deceleration in the export of primary exports was higher than that of manufactured exports, as a result of which the share of primary export has suffered a further decline in the first half of FY2002. New opportunities had opened up for agri-primary and agri-processed exports from Bangladesh as a result of global initiatives such as the EU's *Everything But Arms* (EBA) proposal. There is, therefore, a need to reinforce Bangladesh's effort to increase her exports of agro-based product and address the current problems which inhibit Bangladesh's capacity to take advantage of the market opening for this particular group of products.

**TABLE 2: STRUCTURE OF EXPORTS, INCREMENTAL EXPORTS AND NET EXPORTS  
(JULY-DECEMBER): FY2002 AND FY2001**

(in percent)

Commodities	Structure of Exports		Structure of Incremental Export		Structure of Net Exports		Growth of Net Export	
	FY 2001	FY 2002	FY 2001	FY 2002	FY 2001	FY 2002	FY 2001	FY 2002
Raw Jute	0.94	0.89	0.25	-1.83	1.58	1.49	5.32	-21.41
Tea	0.46	0.35	1.01	-1.42	0.78	0.58	71.10	-33.72
Frozen Food	6.66	5.87	8.85	-18.20	11.14	9.83	33.75	-30.17
Others	0.53	0.61	-0.07	0.32	0.89	1.02	-2.49	6.55
<b>Primary Commodities</b>	<b>8.60</b>	<b>7.72</b>	<b>10.04</b>	<b>-21.13</b>	<b>14.38</b>	<b>12.93</b>	<b>28.51</b>	<b>-27.13</b>
Jute Goods	3.57	3.82	-4.08	-1.57	5.97	6.39	-17.83	-4.84
Leather	3.42	3.34	3.35	-4.08	5.72	5.59	22.85	-13.16
Woven-RMG	52.78	52.62	45.96	-54.04	29.44	29.38	19.81	-11.30
Knit-RMG	22.73	23.46	28.01	-16.84	29.58	30.57	30.56	-8.17
Chemical Products	1.63	1.20	2.15	-5.05	2.72	2.01	33.53	-34.31
Others	7.28	7.84	14.57	-1.23	12.18	13.13	61.34	-1.86
<b>All Mfg. Products</b>	<b>91.40</b>	<b>92.28</b>	<b>89.96</b>	<b>-84.32</b>	<b>85.62</b>	<b>87.07</b>	<b>24.55</b>	<b>-9.28</b>
<b>Total Exports</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>-100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>25.10</b>	<b>-11.85</b>
<i>(in mln US\$)</i>	3383.22	2995.12	642.53	-388.10	1819.67	1617.24		

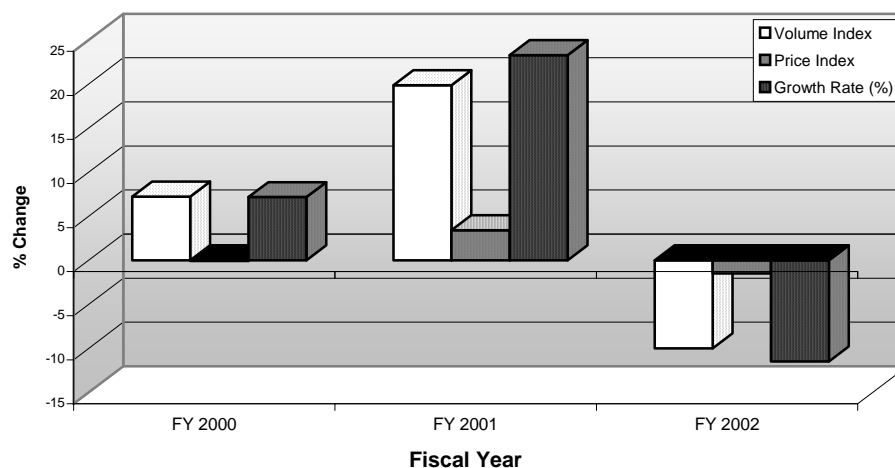
The structure of incremental exports in Table-2 shows that the RMG sector accounts for more than two-thirds of the decrease (about 70%) in the export earnings (\$388.0 million) during the first half of FY2002 compared to the corresponding period of FY2001. As was seen in Table-1, all major export commodities have suffered negative growth during the first half of FY2002. Because of the relative non-diversity of the export base, and Bangladesh's export concentration located in the RMG sector, it is specially difficult for Bangladesh to hedge the risks which originate from fluctuations in the global market.

Because of low value addition in the Bangladesh RMG sector, there is a need to distinguish between gross and net exports. In the particular case of Bangladesh, net exports are substantively lower compared to gross export. Thus, it is not surprising that the decline in RMG earnings account for most of the decrease in Bangladesh's total export earnings in FY2002. Accordingly, growth of net export tends to be higher if and when growth of high value addition exports such as raw jute, jute goods, frozen food and leather are relatively higher, as compared to low value-added goods such as RMG. However, one of the disturbing features of the recent performance of the export sector is that the declining performance has been pervasive across all the sectors. As a result, the negative growth in net exports matched those of the gross export: - 11.9% for net exports as against - 11.5% for gross exports.

### *Contribution of volume and unit value indices*

Changes in the export earnings can be decomposed into two elements: changes in the volume of exports and changes in the unit value of exports which combine to determine the total export growth. What is disquieting is the shift in the relative change in the volume and value indices. In recent years, Bangladesh has been compensating for the stagnating average unit value of her exports by an increase in the volume of her exports (Figure-5). This is indicative of her consistent lack of capacity to graduate to higher value added products, both in case of the RMG products and also other export commodities. This was a major concern which has been flagged in successive IRBDs. As is seen from Figure-5, this trend has continued in FY2002 with the difference that in the first half of FY2002, as a result of globally depressed demand, our export volume declined significantly along with some decline in the average price level.

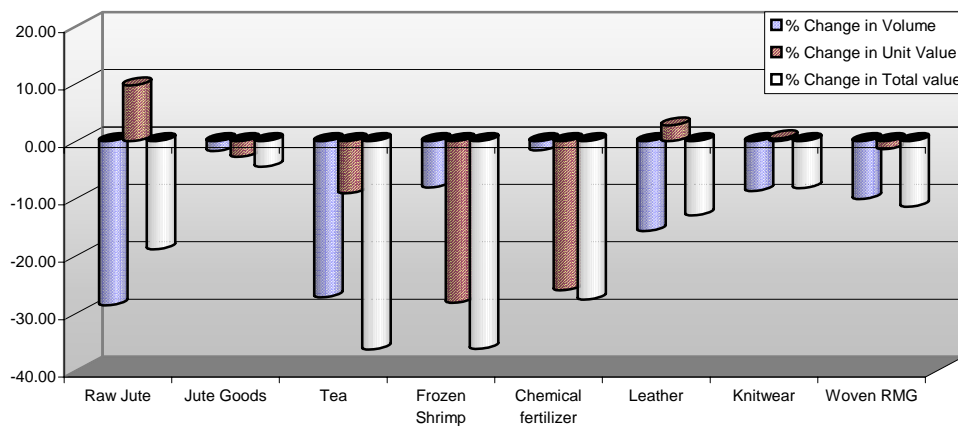
**Figure 5: Decomposition of Total export Growth in Bangladesh for the 1st Half (July-Dec) of Selected Fiscal Year**



As a matter of fact, as Figure-6 bears out, during the first half of FY2002 the average prices of the majority of Bangladesh's exportables suffered decline. There was some increase in the average price level of raw jute and leather (and also knit-RMG to an insignificant level) while the average prices of other items posted some decline. On the other hand, the volume of exports has also gone down, which indicates that a fall in export price does not always translate into a stimulus in export demand. This, in effect, reinforces the findings presented in earlier IRBDs to the effect that Bangladesh exports are *income elastic* rather than *price elastic* and that any recessionary trend in major export markets are likely to have a serious impact on Bangladesh's export

performance. The ongoing recession, thus, goes a long way to explain the present deceleration in the export sector. However, Bangladesh will also need to be sensitive to other developments which are emerging in the global market. Some of these have been flagged in the subsequent section.

**Figure 6: Commodity wise Decomposition of Export Growth in FY2002 (July-December)**



### ***Projections about export performance in the coming months***

The trends in the L/C openings during the past few months may throw some useful insights into the expected performance of the export sector over the remaining months of FY2002. The signs transmitted by data on L/C openings is not very reassuring, to say the least. The amount of L/Cs opened for imports of fabrics under *back to back* (b/b) L/Cs during the last few months was consistently below the levels recorded during the corresponding period of the previous fiscal year. L/C opening for capital machineries for the RMG sector have also slowed down considerably. For instance, the value of L/Cs opened for imports of fabrics under *b/b* L/Cs was Tk. 4524.7 crore during the first half of FY2001; this has come down to Tk. 3889.7 crore in the first half of FY2002, a decline by 14.1%; L/Cs opened for imports of machineries for the garment manufacturers was Tk. 280.5 crore during the first half of FY2001; this has come down to Tk. 191.8 crore during the matched period of FY2002, a sharp decline of more than 31.6%. The trends manifested by the value of L/Cs opened for imports of inputs for the export-oriented RMG sector is a reflection of the disturbing decline in the amount of export orders which are being placed by overseas buyers. Consequently, taking into account the factor of lagged response, it is to be expected that the export of import-intensive commodities such as the RMG are likely to continue their downward trend in the months ahead. The decline in the *price of quota*,

for some categories the price of quota has come down to one-fifth of what it was a year back, is also an indication of the collapsing market confidence.

The only silver lining in the cloud for Bangladesh's exports is that fourth quarter projections about US GDP growth have been revised upward, from 0.2% to 1.4%. This has, in part, been driven by a rise in consumer confidence and an upsurge in consumer buying. Although experts are still not feeling confident enough to suggest an end to the recession, in all likelihood, the US GDP growth will have positive impact on Bangladesh's exports, specially of RMG.

## **II. IMPORT SECTOR PERFORMANCE IN FY2002 (JULY-DECEMBER) AND THE BALANCE OF PAYMENTS SITUATION**

Import sector performance during the first half of FY2002 closely mirrors the negative growth performance demonstrated by the export sector over the corresponding period of FY2002. This section analyses the information on actual imports during the first quarter of FY2002 and the data on L/C opening during the July-December period of FY2002.

### ***Imports during the early months of FY2002***

Exports during the first quarter of FY2002 posted a decline by 5.4% compared to the matched figure for FY2001; during this period imports declined from \$2.24 billion to \$2.12 billion. As can be seen from Table-3, even when imports of foodgrains are excluded the value of imports declines by 5.1%. As can be seen from Table-6, one of the major factors contributing to the fall in imports is the decline in the imports of textile - related items, imports of which came down from \$380 million to \$341 million, a decline of 10.3%. Imports of capital goods, an item having important implications in terms of domestic investment, also came down by about 17.8%. One disquieting fact is that imports into the EPZ also declined by 4.9%.

**TABLE 3: IMPORT OF SOME SELECTED PRODUCTS IN THE FIRST QUARTER (JULY-SEP) OF FY 2002 COMPARED TO THAT OF FY 2001**

(in Million US\$)

Items	July-Sep 2001	July-Sep 2002	Growth Rate(%)
Food Grains	72	62	-13.89
(a) Rice	25	3	-88.00
(b) Wheat	47	59	25.53
Milk and Dairy Products	11	16	45.45
Oil seeds	15	27	80.00
Edible Oil	43	45	4.65
Textile and Articles Thereof	380	341	-10.26
Iron, Steel and other Base Metals	113	116	2.65
Capital Goods	580	477	-17.76
<b>Imports of EPZ</b>	<b>164</b>	<b>156</b>	<b>-4.88</b>
Others	862	880	2.09
<b>Total</b>	<b>2240</b>	<b>2120</b>	<b>-5.36</b>
<b>Total w.o. Food Grains</b>	<b>2168</b>	<b>2058</b>	

Source: Statistics Department, Bangladesh Bank

The structure of imports during the first quarter of FY2001 is indicative of two trends: first, the decline in exports have been reflected in the decline in imports of intermediate inputs such as textile and related articles; *second*, although imports of consumption goods have shown some rise (import of milk and dairy products, oil seeds and edible oil have posted positive growth), imports of capital goods have declined which is likely to have a dampening impact on domestic investment.

#### **Import L/Cs during FY2002 (July-December)**

An analysis of L/Cs opened by importers is important from the perspective of (a) studying the trends of actual imports in the coming months, (b) in terms of understanding the future investment scenario, and (c) likely export performance of sectors which are dependent on inputs procured under *b/b* arrangements.

As Table-4 shows, the amount of L/Cs opened during the July-December period of FY2002 came down by 9.7%, from \$4.55 billion during the first half of FY2001 to \$4.10 billion during the corresponding period of FY2002. If we focus on the import L/Cs opened for non-consumer goods, the decline increases to about 9.9%. What is of significance is that, L/Cs opened for imports of fabrics under *b/b* arrangements have come down significantly, by 19.4%. L/Cs opened for fabrics under the *back-to-back* arrangement during the first half of FY2002 amounts to \$684.2 million compared to

\$848.9 million in FY2001. L/Cs opened for industrial raw materials also came down from \$1879.9 million to \$1690.5 million over the corresponding period, a fall of about 10.1%. The combined impact of the decline in L/Cs opened for imports of industrial raw materials is likely to have negative consequences for domestic manufacturing production over the next few months in FY2002.

In contrast to L/Cs for raw materials, L/Cs opened for import of capital machineries shows an increase of about 23.4% during the first half of FY2002 compared to the corresponding period of FY2001. Interestingly, L/C settlement figures for this group of imports during the matched period is also high, at 37.5%. One interesting aspect to note here is that import L/Cs for textile machineries has gone up from \$75.4 million to \$90.9 million over the corresponding period, an increase of about 20.6%. This testifies to the ongoing effort in Bangladesh to establish backward linkage industries in the textile sector. Other industries where L/Cs opened for import of capital machineries have registered a rise are pharmaceuticals and plastics. On the other hand, as was mentioned earlier, L/Cs opened for capital machineries for the export-oriented RMG sector has come down from \$52.6 million to \$33.7 million, a decline of about 36.1%. L/Cs to import capital machineries for leather industries have also come down by about 38.8%.

**TABLE 4: SECTOR WISE L/Cs (OPENED AND SETTLED) FOR IMPORT:  
JULY-DEC FY2002 COMPARED TO JULY-DEC, 2001**

Sector	(in Million US\$)					
	July-Dec 2001		July-Dec 2002		Growth Rate(%)	
	L/C Opening	L/C Settlement	L/C Opening	L/C Settlement	L/C Opening	L/C Settlement
Consumer goods	269.64	281.95	253.41	257.95	-6.02	-8.51
(a) Food Grains	83.01	101.65	67.26	79.17	-18.97	-22.12
(b) Others	186.63	180.30	186.15	178.78	-0.26	-0.84
Intermediate Goods	361.70	360.82	358.96	370.66	-0.76	2.73
Industrial raw Materials	1879.90	1862.58	1690.46	1733.73	-10.08	-6.92
<i>of which Fabrics Imported under B/B L/Cs</i>	<i>848.91</i>	<i>874.53</i>	<i>684.15</i>	<i>768.67</i>	<i>-19.41</i>	<i>-12.10</i>
Capital Machinery	256.49	225.86	315.55	310.59	23.03	37.51
Machinery for Misc. Industries	366.01	336.00	308.44	338.5	-15.73	0.74
P.O.L Products	478.40	340.68	365.27	338.39	-23.65	-0.67
Others	938.67	777.97	815.66	696.36	-13.10	-10.49
<b>Total</b>	<b>4550.81</b>	<b>4185.86</b>	<b>4107.75</b>	<b>4046.18</b>	<b>-9.74</b>	<b>-3.34</b>
Total w.o. Consumer Goods	4281.17	3903.91	3854.34	3788.23	-9.97	-2.96
Total w.o. Consumer Goods and P.O.L	3802.77	3563.23	3489.07	3449.84	-8.25	-3.18

Exchange Rate:

1 US \$ = 53.30 Taka (for FY 2001)

1 US \$ = 57.00 Taka (for FY 2002)

**Source:** Calculated from MCCI Chamber News, Various Issues.

### *Balance of payments*

As we have seen both exports and imports have suffered negative growth rates during the first half of FY2002 – exports by 11.5% and imports (if L/C opening is considered as a proxy) by 9.8%. As a result, the balance on the trade account registered some deterioration in the early months of FY2002 compared to FY2001. Bangladesh Bank's preliminary data for the first five months shows that imports during the first five months of FY2002 (July-November), at \$3553.0 million, was 6.4% lower than the corresponding period of FY2001 when it was \$3797 million.

First quarter balance of payments data prepared by the Bangladesh Bank is presented in Table-5. As Table-5 shows, during the first quarter, when export earnings declined by about 5.8%, there was a gap of \$315.5 million in the balance of trade which was about the same magnitude as for the corresponding period of the previous year (\$320.5 million).

**TABLE 5: BALANCE OF PAYMENTS SITUATION DURING  
FIRST QUARTER: FY2001 AND FY2002**

	(in Million US \$)		
<b>Items</b>	<b>FY 2001 (July-Sep)</b>	<b>FY 2002 (July-Sep)</b>	<b>% Change</b>
<b>Goods</b>			
Export	1722.89	1608.49	-6.64
Import	2043.34	1924.05	-5.84
<i>Trade Balance</i>	<i>-320.45</i>	<i>-315.56</i>	<i>1.53</i>
<b>Services</b>			
Receipts	189.36	195.65	3.32
Payments	408.31	358.70	-12.15
<i>Net</i>	<i>-218.95</i>	<i>-163.05</i>	<i>25.53</i>
<b>Income</b>			
Receipts	23.86	14.05	-41.12
Payments	66.92	80.05	19.62
<i>Net</i>	<i>-43.06</i>	<i>-66.00</i>	<i>-53.28</i>
<b>Current Transfers</b>			
Official	17.19	77.63	351.72
Private	505.98	606.54	19.87
<i>Net</i>	<i>523.17</i>	<i>684.18</i>	<i>30.77</i>
<b>Current Account Balance</b>	<b>-59.29</b>	<b>139.56</b>	<b>335.40</b>

Exchange Rate:

1 US \$ = 53.30 Taka (for FY2001)

1 US \$ = 57.00 Taka (for FY2002)

**Source:** Statistics Department, Bangladesh Bank.

As is evidenced by Table-5, the current account balance has registered some improvement during the first quarter of FY2002 from – \$59.3 million to + \$139.6 million, mainly due to the significant rise in current transfers. However, the recent

trend of the rising global oil prices, a critically important item of import for Bangladesh, is also likely to raise the burden of the country's import expenditure in the coming months and is expected to put pressure on the balance of trade.

The improvement in the current account balance, mentioned above, is in part, explained by the rise in remittance earnings which has continued to show a robust trend during the first half of FY2002. Remittance flows during July-December period amounted to \$1122.0 million which was 20.9% higher than the corresponding period of FY2001, when it was \$928.0 million. As Figure-7 shows, month for month, remittance was consistently higher in FY2002 compared to FY2001. This increased flow of remittances was, however, not enough to offset the outflow of foreign currency on other accounts and failed to arrest the secular fall in the foreign exchange reserves. As is seen from Figure-8, foreign exchange reserves at the end of each month in FY2002 were consistently below the corresponding levels in FY2001; as a matter of fact, on January 24, 2002 Bangladesh's forex reserves stood at \$1173 million which was 18.4% below the reserves on the corresponding day of 2001. In all possibility, the deterioration in the foreign reserves situation, visible at present, would have been much worse had it not been for the increasing flow of remittances. The pressure on the reserves is likely to continue in the coming months as debt servicing liabilities mature and the burden of payments due to the IOCs rises.

**Figure 7: Monthly Flow of Remittances: 1st half (July-Dec) of FY 2002 Compared to that of FY 2001**

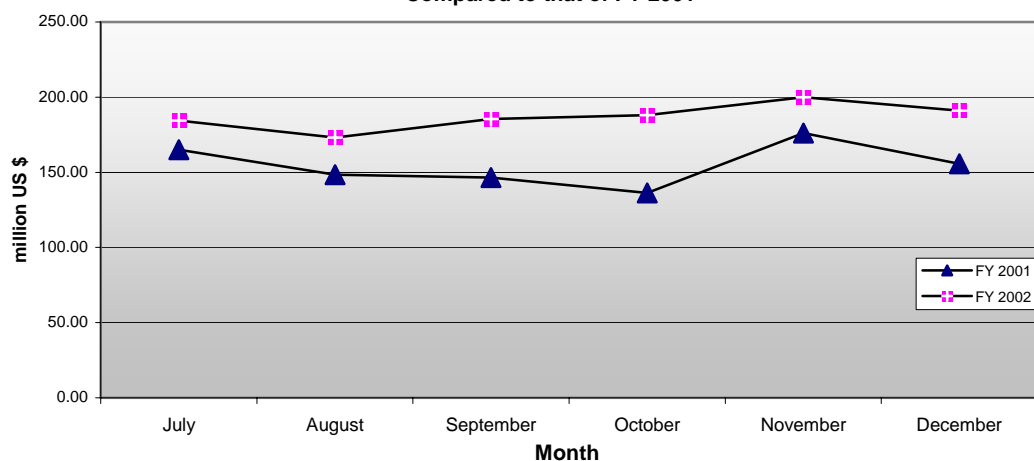
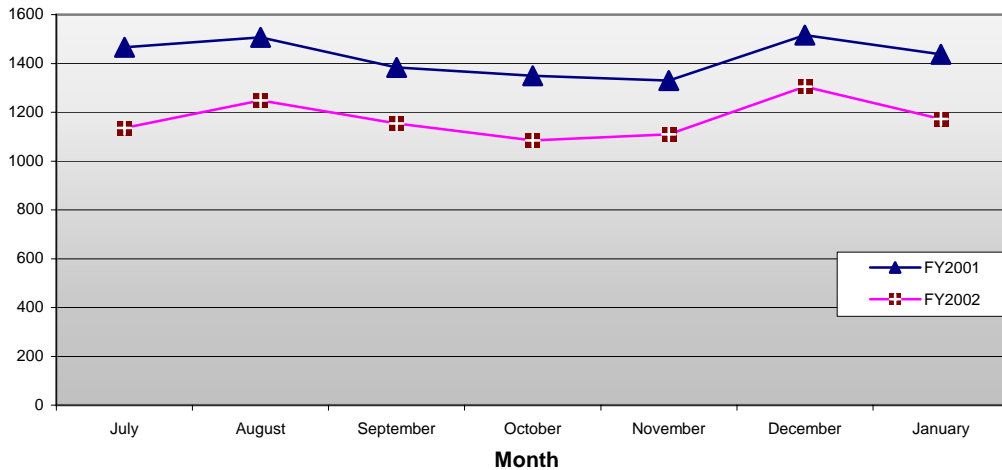


Figure 8: Foreign Exchange Reserves at Various Points of Time



### III. EXPORT SECTOR DECELERATION: TAKING NOTE OF THE LESSONS

#### *Impact of global recession*

The world economy is currently passing through yet another phase of recession. Though there are sharp differences of opinion as regards the beginning of the recession, its depth and severity, contributing factors, and projections about its end, most analysts agree that the recession has by now crossed the critical threshold of eleven months which has been the average period of longevity for the six major post-war recessions. In the beginning it was hard for many to accept that there was at all a downturn in the global economy - after all, following the last global recession of the early 1990s, the world economy has been performing rather well for almost a decade and, as a matter of fact, had attained its highest growth rate for over a decade in the year 2000. However, the world economy started to experience a sharp downturn in the last quarter of 2000 which subsequently continued and deepened in 2001.

Some experts were hoping that there would be an upturn in the global economy by the beginning of the last quarter of 2001. This expectation however, was shattered by the September 11 terrorist attacks in the USA. US growth forecast by the IMF for 2002 has now been revised from 2.2% to a lowly 0.7%. The projections of growth of the world economy for 2002 were cut back from 2.4% to 1.5%. It is to be noted here that such a low growth rate would make 2002 the second consecutive year when economic growth would fail to keep pace with the expansion of the world population. An obvious consequence of this is that the world per capita GDP would continue to

remain static in 2002. OECD growth forecast for 2002, for its 30 member countries, at 1%, is the most gloomy since 1982. Investments have come down significantly and the OECD manufacturing production index has already registered a decline of 2%.

The recession in the global economy could not but have severe negative implications for world trade, a consequence which has had important consequences for Bangladesh's export sector performance in recent months. World trade, which registered a robust growth of 12.5% in 2000, began to slow down in tandem as recession strengthened its grip on the economies of the major trading blocs and countries. Overall growth rate of world trade in 2001 was a paltry 0.8% and though the UN forecast for 2002 is somewhat higher, at 3%, it is still far off the trend line.

Following the September 11 attacks, the growth in world trade during the last quarter was almost zero. The combined impact of the recession and the September 11 terrorist attack on the US economy, which is the single most important export destination for Bangladesh, has been specially severe. The US economy is expected to grow by only 0.7% in 2002; nationally the unemployment rate was 5.8% in December 2001; more than 1.2 million jobs were lost because of the recession. Total unemployment figures in the USA have reached 7.0 million and it is to be noted that this excludes millions of workers who lost part time jobs.

The state of the US economy obviously had a dampening impact on consumer confidence. The consumer expenditure index in the USA is down by 1.8%, the fastest drop since the late 1980s and an all time low since the early 1990s. A report prepared by the WTO projects that the strong slowdown in consumer demand in Western Europe will continue in 2002.

As is well known, Bangladesh's economy had accelerated its pace of global integration in the 1990s. The degree of openness of the Bangladesh economy is now higher than most of the LDCs and many developing countries – exports and imports of goods and services currently account for about a-third of the country's GDP. Thus, by definition, the state of the global economy is likely to have a stronger impact on the Bangladesh economy now than at any time in the past. The impact of the state of the global economy would continue to be increasingly felt in terms of the country's

macroeconomic performance, GDP growth rate, external sector performance, foreign exchange reserves, and health of its financial institutions. This is perhaps one of the most important legacies that the Bangladesh economy has inherited from its reforms and developmental practice in the 1990s.

It is now widely recognized that, as far as developing countries and LDCs such as Bangladesh are concerned, global integration provides both opportunities and risks. Policy makers, therefore, cannot afford to ignore this new reality in the governance of the country. They have to be prepared to both address the attendant risks, and take initiatives to access the emerging opportunities. As global experience shows, increased global integration does not necessarily mean *strengthened global integration*. It is in times of recessions such as the current phase that this dichotomy exposes the inherent challenges for a globalising developing economy such as ours. It also perhaps provides an opportunity to take on, with due urgency, the task of designing the short and medium to long-term policy initiatives and reforms needed address the attendant risk factors in order to make globalisation work for the economy and the people of the country.

Throughout the 1990s, Bangladesh's export sector has been able to post robust growth rates, registering a real growth of more than 10% per annum, double the rate of growth of real GDP over the matched period. To be sure, in recent years, Bangladesh's macroeconomic performance has hinged, to a considerable extent, on the performance of domestic export oriented activities, in terms of investment, employment, financial sector performance and the reserves situation. There was a sense of achievement, not entirely unjustified, in the claim that Bangladesh was in the process of graduating from a predominantly *aid-dependent economy* into a *trade dependent economy*.

The recent depressed performance of the export sector, however shocking, is not entirely unexpected. With the increase in the degree of openness of the economy came an increased vulnerability to the impact of the fluctuating fortunes of the global economy. In recent years, the export sector's continuing success was being exposed to a *litmus test* in the face of the emerging challenges and growing risks originating from an increasingly competitive global trading regime. A confluence of factors has been

undermining Bangladesh's demonstrated strength in global markets, and has undercut her capacity to fully exploit her potential. These factors includes the narrow and shallow export base and lack of diversification, relatively weak domestic linkages of the country's premier export earner, the RMG sector, the inability of the RMG sector to reduce its *lead time* for meeting export orders in the absence of adequate backward and forward linkages, weak institutions and infrastructure. All these factors have raised the cost of doing business for entrepreneurs, encouraged entry of newly emerging competitors into Bangladesh's traditional markets, eroded the preferential margins available to Bangladesh's exports in the face of the general decline in tariff barrier, and global initiatives which provided preferential market access to many of Bangladesh's competitors. In fine, the sector's inherent weaknesses lay in the formidable supply side constraints which weakened Bangladesh's capacity to *translate comparative advantage into competitive advantage*, and the growing market access problems that undermined the ability to *translate competitive advantage into revealed competitive advantage* in the global market place. The current recession has only exposed and accentuated the problems which had already began to constrain Bangladesh's export performance.

#### ***Narrow product base and shallow market base***

Over the past years, the structure of Bangladesh's export has changed quite significantly remarkably. Raw jute, jute goods and leather were some of the major export commodities in the early 1990s, their combined share being equal to the share of RMG in the total exports of Bangladesh. A relatively diversified base and market provided some sort of a cushion against sudden fluctuations in the global market for any particular export. As was mentioned, the context of the current recession contrasts significantly when compared to the period of earlier recessions. Bangladesh's economy is at present more globally integrated than at any time in the past. At the same time the export base has also become increasingly concentrated, both market wise and product wise. For example, the share of RMG exports is now about eight times higher compared to the combined contribution of the abovementioned three products. Markets have also become more concentrated with the USA and EU accounting for about four-fifths of Bangladesh's total exports. Bangladesh does not have a captive market; she has to compete in an increasingly competitive global

environment. On the other hand, as a CPD study shows, Bangladesh's exports are more sensitive to *income* fluctuations and suffers from *price rigidities*. This would mean that exports remain highly sensitive to fluctuations in the income levels in the major developed market economies. Consequently, any recession in these economies is likely to have, and in future will continue to have, increasingly negative consequence for Bangladesh's export sector.

Increasing product and market concentration, weak domestic linkage of export-oriented industries and the shallow domestic market of goods that are exported, make Bangladesh's export sector specially vulnerable to external shocks. Recent global initiatives such as USTDA 2000 and the special preferential treatment accorded by EU and the USA to Pakistan as a consequence of its supportive role in the recent Afghan war, will in all likelihood have an adverse impact on Bangladesh's exports and accentuate the negative consequences of the ongoing recession. *Everything but Arms* initiative of the EU providing LDCs with zero-quota as well as zero-tariff access to the EU market, is not expected to benefit Bangladesh much. A recent study conducted by the Commonwealth Secretariat showed that, from a *static perspective*, Bangladesh's gain from the EBA is expected to be very negligible, about \$8.0 million. Bangladesh, however, stands to gain substantively if such a treatment was accorded globally in which case the gains for Bangladesh are estimated to be \$1200 million annually. However, as is known, the recently held fourth WTO Ministerial Meeting in Doha failed to come up with initiative to expand the EU offer to a global level, particularly because of resistance from the USA, which also happens to be Bangladesh's largest single market.

### ***Emerging concerns***

Apart from the negative impact of the global recessionary trend, other factors are likely to have contributed to Bangladesh's current export deceleration. The *African Growth and Opportunity Act 2000*, popularly known as the US TDA2000, has already started to negatively impact on Bangladesh's export of RMG to the US market. The Act has provided duty-free, quota-free market access to 72 sub-Saharan and Caribbean countries which include 33 least developed countries. The initiative also covers countries such as Honduras, Guatemala, El-Salvador, and Costa Rica which

are major apparel exporters to the USA and directly compete with Bangladesh in a number of apparel categories.

The new US legislative initiative has put the beneficiary countries in an advantageous position because of a number of reasons: (a) tariffs on apparels exported to the US market are still relatively high, averaging about 20%, which provides considerable edge to the beneficiary countries which enjoy zero-tariff access to the US market; (b) the aforementioned countries are located in geographical proximity to the USA, hence enjoying lower transport costs as well as a much shorter lead time compared to Bangladesh; (c) these countries are also not subjected to any quota on exports of apparels to the USA. Additionally, it should also be kept in mind that the advantages offered to the sub-Saharan countries may, in the medium to long term, divert exports from Bangladesh when investments begin to flow to these countries to take advantage of the greater market access under the US TDA2000. Some of Bangladesh's traditional buyers have already begun to explore the Caribbean sources for their RMG supplies immediately after the US TDA2000 was announced. Some export diversion is already on, and exports from these countries to the USA have been on the increase in recent months, some of which has been directly at the expense of Bangladesh.

It is important to remember that US TDA2000 came into existence following the establishment of the *North American Free Trade Agreement* (NAFTA) in 1994 which granted Mexico an unrestricted access to the US market. Mexico has increased her share in the US apparels market from 4.6% to 14.1% over a six year period between 1994 and 2000.

The recently signed *Israel-Jordan Free Trade Agreement* also allows for potential market diversion as far as Bangladesh is concerned. Accession of China to the WTO, a country that accounts for 16.2% of global apparels export compared to Bangladesh's 2.1%, should also be seen as a development of major consequence not only for Bangladesh's RMG sector, but also the export sector as a whole.

As is known, recently, as a goodwill gesture, USA has offered Pakistan a package through which the country's textile export quota was enhanced by 15%. The package allows Pakistan a duty rebate equivalent to 7% and is expected to provide her

financial benefit to the tune of upto \$ 1.0 billion. Since, Pakistan is a major competitor of Bangladesh's apparel products in the US market, this has obviously placed Bangladesh in a disadvantageous situation. It is also being mooted that India may receive similar facilities from the USA. Evidently, as far as Bangladesh is concerned, these developments are going to aggravate an already delicate situation.

### ***Initiatives to address the emerging concerns***

The recent debacle must serve as a wake up call for Bangladesh's policy makers who will need to take cognisance of the current difficulties and come up with short and medium term strategies to address these emerging concerns.

It is to be noted that Bangladesh's policy makers did indeed come up with a number of initiatives in view of the emerging difficulties experienced by the export-oriented sector of the country. These include: reduction in the bank rate, slashing of interest rates, a refinancing facility for credits to export-oriented sectors. Some proposals to reduce freight rates for exportables and also reduction of VAT and AIT in case of exports are also being considered. Earlier, export-import procedures were further simplified to reduce the hazards faced by the entrepreneurs. The government is examining the viability of setting up central bonded warehouses in the private sector to curtail the lead-time for export of RMG, and is considering whether to accept EU's offer to provide a *SAARC Regional Cumulation facility*. However, a note of caution is perhaps called for here. Any decision as regards central bonded warehouses and regional cumulation must take into cognisance the interests of the backward linkage textile sector of Bangladesh and should be made through an *inclusive* process that ensures effective participation by all important stakeholders.

Bangladesh should now concentrate on exporting more value added and higher priced commodities to the global market. The implications of Bangladesh's being a hostage to the lower market segment of the global demand curve are becoming increasingly evident in the context of recent developments. In order to enhance its competitive strength and cut down on the leadtime, Bangladesh needs to have in place adequate backward linkages in textiles to support the export oriented RMG sector. The market for apparels is a hugely diversified one, and there will be a need to identify the niches where Bangladesh obtains maximum return for her efforts in this area. A recent study

carried out by the Centre for Policy Dialogue shows that an investment to the tune of about 16,000 crore taka will be needed in order to establish the necessary backward linkage units in the textiles sector for setting up the required number of spinning, weaving, dyeing and finishing units for the export-oriented RMG sector. Since in all likelihood the investment will have to be made by the private sector, a conducive policy environment will have to be created to facilitate, encourage, promote and realise such a level of investment through capital flows, both domestic and through FDI, in these activities.

In preparing the RMG sector to cope with these emerging challenge the government cannot afford to play a passive role, in the expectation that its incentive package will automatically generate a supply side response. The government must assume a proactive role in ensuring that investments in a both new generation of backward linkage as well as a new generation of export industries does actually take place within an identified time period. This will require innovative action in mobilising investment finance, initiatives to provide adequate support to existing, and new fashion and design institutions, major investment in training facilities for workers to service the export-oriented industries such as RMG and leather and providing financial support to new exporters.

Unlike in many countries, in Bangladesh, this far, the spill over impact of export-processing zones (EPZ) to the domestic tariff area (DTA) has been minimal in terms of technology transfer. The government will need to give priority attention to the issue of stimulating transfer of technology to the export-oriented industries in the country and support skill upgradation. It should be explored if the quite formidable capacity in Bangladesh's NGO sector can be brought into play to facilitate this process. Bangladesh will need to redouble her endeavours to move up market where a blending of technology and relatively cheap labour are likely to ensure maximum returns to domestic export-oriented activities. A comprehensive strategy to ensure a foothold for Bangladesh in the growing global service sector market is also long overdue.

Diversification of Bangladesh's export market must accordingly receive the priority attention of our policy makers. Aggressive marketing and the search for new markets

should now receive priority. Small and medium scale enterprises need to be supported in their efforts to enter the export market. Market analyses shows that Bangladesh's agro-processed commodities have a promising export potential, specially in the markets of the EU and Japan. In the context of the zero-tariff, zero-quota market access under the *everything but arms* proposal of the European Union (EU-EBA) and the LDC-friendly new GSP scheme offered by Japan, substantial market openings may be expected, particularly for exports of agro-processed goods and poultry products from the LDCs to these markets. The Government of Bangladesh should put in place a comprehensive package of incentives and support to encourage compliance with stringent quality control measures, a crucial precondition for market entry in case of agricultural and food products. However, corresponding attention will need to be given to preparing our farmers, to also enhance their productivity as well share in the value addition provided through the export of agro-processed products.

A more proactive role at the global level is also becoming an imperative for Bangladesh. A provision in the WTO Articles stipulates that in the *WTO, countries get not what they deserve, but what they negotiate*. There is an urgent need to create a cadre of professionals with adequate analytical capability and negotiating skills to promote Bangladesh's interest in the context of an evolving global trading regime. The government should, thus, actively consider the proposal for establishment of a foreign trade institute in the country. This is specially important in view of the launching of a new round under the aegis of the WTO which will deal with multilateral agreements on such issues of crucial interest to Bangladesh as agriculture, services, investment, competition policy and environment. These issues are likely to dominate the global trade agenda for many years to come.

Addressing the impact of the phase-out of MFA should receive top priority from Bangladesh's policy makers. In the event that a protracted phase out, or/and an accelerated quota expansion, is not feasible, Bangladesh will need to direct her attention towards a global zero-quota, zero-tariff market access for the 49 LDCs. It should be noted that tariffs on textiles/apparels will still be there even after the quotas are phased out in the post MFA period. These tariffs, averaging 12.5% in the EU and ranging between 15-22% in the USA at present, are likely to continue to be at relatively high levels following the MFA phase-out on January 1, 2005. At present

tariff rates in the OECD countries range in average between 4-6%. However, tariffs on agro-products, leather and food items continue to remain very high. These products, along with RMG, are items where, amongst the LDCs, Bangladesh is perhaps one of the best positioned countries in terms of taking advantage of any enhanced market access offered by the OECD, specially the *quad* countries (USA, EU, Japan, Canada). Bangladesh should keep this in mind and strategise accordingly.

## **CONCLUDING REMARKS**

As a matter of fact, a number of areas requiring policy intervention directed towards raising the competitiveness of Bangladesh's export-oriented sector and enhancing trade related capacity building have already been identified and put on the table. The task now is to seriously get on with the business of implementing the agenda. The upshot of the above discussion is to reemphasise that in the coming months and years Bangladesh's increasingly globalised economy will, of necessity, have to be adequately prepared to face the consequences of the fluctuating fortunes of the global economy. The current crisis facing Bangladesh's export sector should transmit appropriate signals to the country's policy makers to the effect that greater integration into the global economy is not an unqualified blessing. Bangladesh cannot afford to be a passing taker in the globalisation process. We must *strengthen our capacity to participate in global integration* to a point where it can improve the terms on which we participate in this process. The price to be paid from globalisation will rise in direct proportion to the degree of the country's lack of preparedness. The ongoing deterioration in Bangladesh's export performance should thus serve Bangladesh both as a *wake-up call*, and as a *warning bell* to prepare ourselves for the next round of the struggle for globalisation.

It is somewhat encouraging that initial signs of global recovery have become visible. US projections for the fourth quarter give reason for some optimism. The unified market of the European Union, under the *euro*, should also provide better market opportunities if Bangladesh is able to put in place the incentives and policies to realise the potential opportunities created by the EU-EBA and other global initiatives taken on a bilateral or multilateral basis. We will accordingly need to address the stringent

rules of origin criteria and strict quality control requirements such as the HACCP and SPS to benefit from the opportunities on offer to us.

We have to come to terms with the fact that the global market for apparels will undergo major structural changes with the phasing out of the MFA in January, 2005; preferential margins enjoyed by the LDCs such as Bangladesh are going to be significantly eroded in the face of declining tariffs while competition in the global market will become more intensive with participation of more and more countries in the products and markets where traditionally Bangladesh has enjoyed some competitive advantage. From a medium to long-term perspective, export diversification and movement upmarket should be the twin objectives for Bangladesh's export strategy. Evidently all the stakeholders including the government and the private sector will need to be proactively involved if these objectives are to be realised.

It is well recognised and appreciated that Bangladesh's private sector has played a defining role in export success story of the RMG sector. We should also recognise the heroic contribution of the 1.5 million garment workers, mostly women from the rural areas who have provided much of the value addition generated by our RMG exports, and successive governments have also put in place many supportive policies, institutions and incentives to stimulate and promote the sector. However, as recent experience would bear out, evidently much more needs to be done, and that too on an urgent basis if Bangladesh's export sector is to recover its lost ground. On the other hand, Bangladesh's export sector has registered double-digit real growth rate throughout the 1990s. As a matter of fact, the real export sector growth rate was about three times higher than the real GDP growth rate during this period. Even during FY 1990 and FY 1991, a period which coincided with the last major global recession, Bangladesh's export sector posted robust growth rates of 17.9% and 12.7% respectively. If the past is any clue, there is no reason why Bangladesh should not succeed in its endeavour to regenerate our export growth. But this will not happen without a major collective effort to secure a more sustainable niche for Bangladesh in the global market place. ■