Strategies to Strengthen Bangladesh's Competitiveness: Thematic Assessments

A Bangladesh Diagnostic Trade Integration Study: Volume 2



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Acronyms and Abbreviations

ADB Asian Development Bank ADM application development and maintenance AEO Authorized Economic Operators AFL-CIO American Federation of Labor and Congress of Industrial Organizations AGOA African Growth and Opportunity Act AMTAC American Manufacturing Trade Action Coalition APEC Asia-Pacific Economic Cooperation APIs active pharmaceutical ingredients APTA Asia-Pacific Trade Agreement ASEAN Office of American Schools and Hospitals Abroad ASYCUDA Automated System for Customs Data ATAB Association of Travel Agents of Bangladesh ATPA Andean Trade Preferences Act ATPA Andean Trade Preferences Act ATPDEA Andean Trade Promotion and Drug Eradication Act BASIS Bangladesh Bank BBS Bangladesh Computer Council BCC1 Bangladesh Computer of Commerce and Industry BCSL Bangladesh Cable Shilpa Limited BEST-BQI Better Work and Standards—Better Fisheries Quality BEST-BQI Better Work and Standards—Better Quality Infrastructure BGMEA Bangladesh Institute of Development Studies </th <th>ACI</th> <th>Advanced Chemical Industries Limited</th>	ACI	Advanced Chemical Industries Limited
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	BSCIC	Bangladesh Small & Cottage Industries Corporation
BSTI Bangladesh Standards and Testing Institute	BSTI	Bangladesh Standards and Testing Institute
BTB back-to-back	BTB	back-to-back
BTMA Bangladesh Textile Mills Association	BTMA	Bangladesh Textile Mills Association
BTRC Bangladesh Telecommunication Regulatory Commission	BTRC	Bangladesh Telecommunication Regulatory Commission
BTTB Bangladesh Telegraph and Telecommunications Board	BTTB	Bangladesh Telegraph and Telecommunications Board

BUET	Bangladesh University of Science and Technology
BUILD	Business Initiative Leading Development
BWH	bonded warehouses
CAFTA-DR	Dominican Republic–Central America Free Trade Agreement
CBI	Caribbean Basin Initiative
CBTPA	Caribbean Basin Trade Promotion Act
CCIE	Chief Controller of Exports & Imports
CGE	computable general equilibrium
CGENS	Commission on Graduates of Foreign Nursing Schools
cGMP	current good manufacturing practice
CIF	cost insurance and freight
CMR	Convention on the Contract for the International Carriage of Goods by Road
CMT	cut-make-trim
CNC	computer numerical control
CNG	compressed natural gas
CPD	Centre for Policy Dialogue
CRR	centralized risk registry
CSIC	China Shiphuilding Industry Corporation
CSR	corporate social responsibility
CSSC	China State Shinbuilding Corporation
CTS	Council for Trade in Services
CD	customs duties
D-8	Developing 8 Group
DANIDA	Danish International Development Agency
DEDO	Duty Exemption and Drawback Office
D/C	documentary collection
DCCI	Dhaka Chamber of Commerce and Industry
DGDA	Directorate General of Drug Administration
DTIS	diagnostic trade integration study
dwt	dead weight tonnes
FBA	Everything But Arms
EDE	Everything Dut Athis Export Development Fund
FFF	Equity Entrepreneurship Fund
ECE	export contract finance
ECGS	Export Credit Guarantee Scheme
FIAP	Export Credit Guarance Science
EDM FPAs	export promotion agencies
EPR	Export Promotion Bureau
EP7	export processing zone
FRP	effective rate of protection
ERG	Export Pating Scheme
ERS	Export Remaining Science Ethiopian Taxtile and Garment Manufacturers Association
FU	European Union
EWOE	European Onion Expatriates' Walfare and Overseas Employment
EVOL	Explanates werrate and Overseas Employment Food and Agriculture Organization
FRCCI	Food and Agriculture Organization
FOUL	Foreign Corrupt Practices Act
FDI	foreign direct investment
FE	fixed affects
FER A	Foreign Exchange Regulations Act 1947
FOR	free on board

FPIPPA	Foreign Private Investment Promotion and Protection Act
FTA	free trade agreement
FVO	Food and Veterinary Office
FY	fiscal year
GAFTT	Global Alliance for Fair Textile Trade
GATS	General Agreement on Trade in Services
GHERS	Greater Harvest and Economic Returns from Shrimp
GIS	geographic information system
GMP	good manufacturing practice
GSO	General Statistics Office
GSP	General System of Preferences
GSP+	General System of Preferences +
GT	gross tones
GTFP	Global Trade Finance Program
GTLP	Global Trade Liquidity Program
GTSF	Global Trade Supplier Finance
НАССР	hazard analysis and critical control points
HELP	Haiti Economic Lift Program
HOPF II	Hemispheric Opportunity for Partnership
HS	Harmonized Commodity Description and Coding System
IAF	International Accreditation Forum
	International Apparel Federation
IAR	Investing Across Borders
ICB	Investment Corporation of Bangladesh
	International Chamber of Commerce
ICCB	International Chamber of Commerce Bangladesh
ICP	International Comparison Project
ICSID	International Comparison Project
	International Jute Study Group
	International Laboratory Accreditation Cooperation
ILAC ID	intellectual property
	Import Policy Order
	intellectual property rights
	Internetional Standard Industrial Classification
	India Sai Lonka Fraza Trada Agreement
ISLFIA	International Standardization Institutions
	information technology
	information technology
II-DPU	information technology—business process outsourcing
ITES-DFU	Information technology enabled services—business process outsourchig
	International Fradick Longuage Testing System
IELIS	IT analysis and a services
	In-enabled services
JICA	Japan International Cooperation Agency
	knowledge process outsourcing
KWN	kilowali nour
L/C	
LCS	Land Customs Stations
	least-developed country
LDCI	Least Developed Country Initiative
LFMEAB	Leatnergoods & Footwear Manufacturers & Exporters Association of Bangladesh
LPI	Logistics Performance Index

LPO	legal process outsourcing
LIS	land information system
MBCCI	Malaysia-Bangladesh Chamber of Commerce and Industry
MCCI	Metropolitan Chamber of Commerce and Industry
MFA	Multi Fibre Arrangement
MFN	most favored nation
MIGA	Multilateral Investment Guarantee Agency
MNCs	multinational companies
MoARD	Ministry of Agriculture and Rural Development
MoC	Ministry of Commerce
MoCB	Ministry of Capacity Building
MoE	Ministry of Education
MoI	Ministry of Information
MoPT	Ministry of Post and Telecommunications
MoSICT	Ministry of Science and ICT
MoTI	Ethiopian Ministry of Trade and Industry
MOU	memorandum of understanding
MPV	multipurpose vessel
MRA	mutual recognition agreement
NABL	National Accreditation Board for Testing and Calibration Laboratories
NBR	National Board of Revenue
NDP	National Drug Policy
NECD	Non-Resident Foreign Currency Deposit
NIP	National Industrial Policy
NIPFP	National Institute of Public Finance and Policy India
NORAD	Norwegian Agency for Development Cooperation
NPR	nominal protection rate
NSR	National Standardization Body
NTB	non-tariff harrier
OBM	original brand manufacturer
ODM	original design manufacturing
ODYs	off-dock vards
OFCD	Organisation for Economic Co-operation and Development
OFM	original equipment manufacturer
OIC	Organization of the Islamic Conference
OPIC	Overseas Private Investment Corporation
OTRI	Overall Trade Restrictiveness Index
OTS	Operative Tariff Schedules
PFF	Public Finance Foundation
PIC/S	Pharmaceutical Inspection Convention/Pharmaceutical Inspection Co-operation Scheme
ριέρα	Philippines-Japan Economic Partnershin Agreement
PRI	Policy Research Institute
PRICE	Poverty Reduction by Increasing Competitiveness of Enterprises
PSDSP	Private Sector Development Support Project
PSI	pre-shipment inspection
PTR	German Metrological Institute
R D	regulatory duty
	research and development
RDRs	regional development banks
RISC	Registrar of Joint Stock Companies
RMG	registrar of John Stock Companies
NNO	reauy-made garment

RoO	rules of origin
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asian Free Trade Area
SBC	Sadharan Bima Corporation
SBSRB	Ship Building and Ship Recycling Board
SBW	special bonded warehouse
SCF	supply-chain finance
SD	supplementary duty
SOEs	state-owned enterprises
SGS	Société Générale de Surveillance
SICT	Support to ICT Task Force
SLECIC	Sri Lanka Export Credit Insurance Corporation
SMEs	small and medium enterprises
SME	square meter equivalents
SMM	Shipbuilding, Machinery and Marine Technology International Trade Fair in Hamburg
SPS	sanitary and phytosanitary
SROs	Statutory regulatory orders
STRI	Services Trade Restrictiveness Index
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TAI	Textile and Apparel Institute
TBT	Technical Barriers to Trade
TCB	Trading Corporation of Bangladesh
TCI	trade complementarity index
TEU	20-foot equivalent unit
TFP	Trade Finance Program
TIR	Transports internationaux par la route
TRQ	tariff rate quotas
TTCs	Technical Training Centers
TTRI	Tariff Trade Restrictiveness Index
TTSC	Textile Training and Support Centre
TVET	technical and vocational training
TWP	temporary work permit
UD	Utilization Declaration
UNCTAD	United Nations Conference on Trade and Development
UNICEF	United Nations Childrens Fund
UNIDO	United Nations Industrial Development Organization
UNWFP	United Nations World Food Programme
USAID	United States Agency for International Development
USTR	United States Trade Representative
VADP	value added at domestic prices
VAT	value-added tax
VAWP	value added at world prices
Vinatex	Vietnam Textile and Garment Group
VSAT	very small aperture terminal
WBG	World Bank Group
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

Bangladesh's Trade Performance

1.1 The Government of Bangladesh recognizes that export-led growth and a broadening of the country's export structure is pivotal to its growth ambitions. In the Sixth Five Year Plan (6FYP), trade is considered as a strong source to accelerate growth, and to provide high productivity and high income jobs. The government recognizes that a dynamic manufacturing sector will benefit from greater outward orientation, particularly based on the experience of other successful Asian exporters such as Korea, China, India, Thailand, and Vietnam. The government has put emphasis on product and market diversification, and regional and global integration. The Sixth Five Year Plan (6FYP) projects "...the share of exports in relation to GDP to rise by 7.7 percentage points to 23.9% of GDP by the end of the 6FYP, reflecting a leading role that export sector is envisaged to play in increasing domestic activity."

1.2 This chapter describes the trade performance of Bangladesh at the macro and micro levels, for both goods and services. The analysis of the basic orientation of trade is crucial to judge the extent to which a country's trade structure is conducive to future growth. The analysis of trade performance at the aggregate and sectoral levels will be complemented by a micro analysis based on detailed firm-level data from Customs, the Trade Outcomes Analysis. It uses the decomposition of the margins of trade growth as a framework for exploring trade competitiveness, and analyzes the *level, growth, and market share* performance of existing exports (the intensive margin) of exports, as well as *market share* performance of new exports.

1.3 Complementing more aggregate assessments with firm-level data can lead to improved understanding about competitiveness. Firms are heterogeneous in characteristics and performance. Moreover, important changes in production models are taking place worldwide, which are deeply affecting economies' transmission mechanisms, both domestically and internationally. Macro aggregations miss the critical features and effects of firm heterogeneity on the macro-economy. After briefly describing the overall external environment in Bangladesh, the chapter provides a thorough analysis of the merchandise trade performance, including that based on Customs transactions data. It then presents the performance of services exports.

1.4 The analysis highlights: (i) the heavy sector and market concentration of exports; (ii) potential to improve trade performance by penetrating new markets and exporting new products. The low entry and exit rates of firms suggest competitiveness challenges likely driven by weaknesses in the general export environment; and (iii) untapped potential in services exports despite a noticeable increase in services exports, driven by the growth in communications services and in other business services (including engineering, consulting, and other professional services), which reflects Bangladesh's large pool of manpower and growing opportunities in emerging services such as skill-intensive and professional services. Overall, the analysis suggests that there is potential to intensify exports based on the existing factor endowment (large pool of unskilled labor)—i.e. existing exports can grow significantly, both in current and new markets. Data suggests that Bangladesh will have to work harder to produce another large, labor-intensive cluster like garments, but its export presence in a wide variety of manufactured products indicates that it is possible, with the right supporting environment and with skill upgradation.

1 Bangladesh's Performance in Trade

1.1 Overall external environment

1.5 Bangladesh has posted a robust and resilient economic performance over the past decade, accompanied by a sustained decline in poverty. Real GDP grew at a healthy rate of around 6 percent per annum (Table 1) over the past decade, accelerating by a percentage point compared to the previous one. GDP growth was remarkably stable with a low standard deviation of 0.7 percent during this decade (half of what it was from a decade earlier). This robust growth was accompanied by a uniform and steady decline in poverty headcount rates between 2000 (48.9 percent) and 2010 (31.5 percent), and a continuous decline in the number of poor people—from nearly 63 million in 2000 to 47 million in 2010, despite a growing population.

1.6 Economic growth accelerated largely since the 1990s, because of the accumulation of physical capital, increase in the size of the labor force, and to a much smaller extent, an increase in total factor productivity.¹ Underpinning this were several economic reforms: sound macro-economic management, targeted trade policy reforms that enabled the garment sector to thrive and similarly-focused policies that facilitated take-offs in other specific sectors such as frozen foods in European markets, import and financial sector liberalization, and investment in human development and social protection. Remittances and garment exports were the twin drivers of growth in the economy—remittances through their effect on consumption and construction as well as easing the foreign exchange constraint, and garments, input and ancillary suppliers, etc. Also, the manufacturing sector has been the largest single contributor to growth in the past two decades. As a result, the share of manufacturing in total GDP increased from 10.8 percent in FY13. Modest investment rates notwithstanding, capital deepening in both agriculture and industry played an important role.

1.7 Bangladesh has also proven to be relatively resilient to global economic shocks. Its growth continued to be resilient despite several external shocks that slowed exports, remittances, and investment growth, including the end of the Agreement on Textile and Clothing (ATC) in 2005 and the 2008-09 global financial crisis, thanks largely to strong fundamentals at the onset of the crisis, relatively under-developed and insulated financial markets as well as pre-emptive policy response. However, while slow growth in Europe and the US, the two main export markets, recently put strains on Bangladesh's export growth, exports have recovered and grown at a reasonable pace.

1.8 The current account and balance of payments have been stable, thanks to remittances. Bangladesh relies heavily on imports for capital goods, oil, intermediates, and even a variety of consumer goods. Exports are not sufficient to pay for all imports, but the current account has been positive since FY06, owing to growing remittances, which have proved critical to the stability of the balance of payments. Despite some concerns in FY11 and FY12 about oil imports and their impact on the balance of payments, the external sector has by and large proved very stable over the years. Reserves have grown, and stood at almost five months of goods and services imports in FY13. Macroeconomic pressures that had developed on account of energy subsidies have also eased recently, supported by more restrained fiscal and monetary policies.²

1.9 However, despite the stable macroeconomic situation, institutional weaknesses and several vulnerabilities loom large, and pose challenges for macroeconomic management. The ongoing political uncertainty, together with frequent general strikes and associated violence, has added to the longstanding

¹ For a detailed analysis, see World Bank (July 2007), "Bangladesh: Strategy for Sustained Growth," and World Bank (2012b).

² see IMF 2013, http://www.imf.org/external/pubs/ft/scr/2013/cr13157.pdf, for details.

energy and infrastructure deficits in dampening investment, posing a nontrivial threat to sustaining the recent average 6 percent growth, let alone raising it to 7 percent in the near future. Moreover, deep rooted institutional capacity weaknesses underlie the failure to speed up implementation of top priority infrastructure projects, and are not easily addressed.

1.10 Bangladesh's near and medium-term macroeconomic outlook is subject to several vulnerabilities. These include prospects of a resurgence in inflation arising from expected wage increases if not matched by commensurate increases in productivity; a possibility of export slowdown; fiscal expansion due to increased recurrent expenditures in response to political pressures; a weak financial system that has been further exposed by recent stock market volatility and financial scams; and remittance inflows that have become vulnerable with the recent sharp decline in the number of workers going abroad.

	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13
Output and prices									
Real GDP growth (in percent)	6.0	6.6	6.4	6.2	5.7	6.1	6.7	6.2	6.0
Gross investment (percent of GDP)	24.5	24.7	24.5	24.2	24.4	24.4	25.2	26.5	26.8
CPI inflation (average)	6.5	7.2	7.2	9.9	6.7	7.3	8.8	10.6	7.7
External accounts									
Exports (US\$ million)	8,655	10,526	12,178	14,111	15,565	16,205	22,924	24,288	27,018
Annual % change	13.8	21.6	15.7	15.9	10.3	4.1	41.5	5.9	11.2
Garments/Total exports (%)	74.2	75.1	75.6	75.8	79.3	77.1	78.1	78.6	79.6
Imports (US\$ million)	13,147	14,746	17,157	21,629	22,507	23,738	33,658	35,441	33,575*
Annual % change	20.6	12.2	16.3	26.1	4	5.5	41.8	5.3	-0.4*
Remittances (US\$ million)	3,848	4,802	5,979	7,915	9,689	10,987	11,650	12,843	14,456
Annual % change	14.2	24.8	24.5	32.4	22.4	13.4	6	10.2	12.6
Current account balance (% GDP)	-0.9	1.3	1.4	0.9	2.7	3.7	0.8	1.5	2.0*
Gross official reserves (US\$ million)	3,024	3,484	5,077	6,151	7,471	10,750	10,912	10,325	15,576
In months of GNFS imports	2.6	2.8	3.4	3.4	3.7	5.1	3.9	3.3	4.9

Table 1.1: Key Macroeconomic Indicators, FY05–FY13

Source: Bangladesh Bureau of Statistics, Bangladesh Bank, Export Promotion Bureau, Ministry of Finance, IMF and World Bank Staff estimate. * Till FY13 July-May

1.11 Bangladesh's export growth has been impressive since the early 1990s, and it has been accompanied by reduced distortions in trade policy. While still a least-developed country (LDC), Bangladesh has an unusually high share of manufactured exports in its export basket (95% in 2012) relative to its income level, which illustrates its strengths in mass manufacturing and labor availability. Economic growth has been associated with greater trade openness over the past two decades. As measured by the ratio of exports plus imports to GDP, openness has increased from 16 percent on average in the 1980s to over 40 percent in the 2000s (figure 1.1). A reduction in trade policy distortions has helped Bangladesh's export competitiveness to a significant extent.

Figure 1.1: Trade Openness in Bangladesh and Comparators, Measured by Exports and Imports as a Share of GDP



Source: Calculations based on Export Promotion Bureau and World Development Indicators data.

1.12 Primarily due to the emergence of a dynamic readymade garments (RMG) industry, Bangladesh has doubled its world market trade share during the last decade, from 0.08 percent in 1995 to 0.16 percent in 2011. Its overall exports grew on average by 11.2 percent from FY 2000/01 to FY2009/10. During 2005–10 Bangladesh gained world market share in most of its top 25 export products (figure 1.2). Exports remained strong during the 2008–09 crisis, owing to the so-called "Walmart Effect," driven by the low-value garment exports.



Figure 1.2: Growing Share of Bangladesh's Top 25 Exports in World Markets, 2005–10

Source: Calculations based on UN Comtrade data.

Note: Products are identified by six-digit Harmonized System (HS) codes The bubbles in the figure are relative to the importance of the product in the Bangladesh export basket and the straight line shows the points at which world and Bangladesh growth rates are the same. CAGR = compound annual growth rate.

1.13 Bangladesh has scope to diversify its exports and increase the contribution of trade in growth and poverty reduction. Although growing over time, the role of trade in the overall economy is still low. Imports were 32.1 percent of GDP while exports were 23.1 percent of GDP in FY 2011/12. Exports lack

diversity, with garments accounting for four-fifths of total exports. Bangladesh is sometimes referred to as a "mono-product" export basket. Market concentration is also high. More importantly, there are concerns whether physical and institutional infrastructure as well as skill availability can keep pace with the desired growth rate of Bangladesh's exports. Also, trade policy has not been used in a deliberate way to enhance consumer welfare or to promote export competitiveness in general. Neither has it been mainstreamed as a critical policy for long-term growth.

2 Bangladesh's Performance in Goods Trade

2.1 Sector and market concentration

Bangladesh's export portfolio has been dominated by RMG, -- knitwear, and woven garments in 1.14 particular. In FY 2011/12, RMG represented 78.6 percent of total exports (figure 1.3), and most of the growth has come from the RMG sector over the years. Within the RMG sector, the knitwear sector has grown at 18.4 percent over FY 2001/10; woven garments during the same period grew at 7.2 percent. The main reason for this difference is that EU rules of origin (RoO) required a "double transformation" from yarn to fabric and from fabric to garment to be eligible for lower duties under the Generalized System of Preferences (GSP). These RoO benefitted the knitwear industry, which was more likely to meet the required local content. Domestic value addition in knitwear is about 75 percent, thanks to strong backward linkages to spinning factories, with local factories supplying about 90 percent of the total fabric required. By contrast, only about 16 percent of the woven exports to the EU qualified for the GSP facility because imported fabric typically accounted for 60 percent of the output price. However, effective January 2011, the EU's rules of origin have been relaxed, which has already improved the performance of woven garments (see chapter 3 on market access for a discussion of GSP). In the following two years, FY 2011/13, woven garments exports grew at a rate of 15 percent while knitwear growth was barely 6 percent.



Figure 1.3: Bangladesh's Top Export Products, FY 2012/13 (percent of total export)

Source: Export Promotion Bureau

1.15 The concentration in garments still appears to be unique to Bangladesh among many peer countries. Figure 1.4 shows that between 2000 and 2008, this concentration increased further, and garments' share in Bangladesh's exports rose from 75 to 79 percent. In other countries such as Lesotho, Pakistan, and Sri Lanka, where per capita incomes have grown slower than Bangladesh's over 2000–08,

the reliance on garments has declined substantially. In high-growth countries like China and India, the relative reliance on garments has been declining even faster.





Concentration of both export markets and products is very high. Bangladesh's exports are heavily 1.16 concentrated at the sector level and even at the product level, where five products³ account for over 50 percent of sales in the U.S. and EU markets. Twenty-one out of the top 25 products are clothing articles. In general, product concentration in Bangladesh is much higher than in comparators (figure 1.5 shows the number of products exported by countries). Similarly, in terms of markets, the EU and United States together account for about two-thirds of the country's total exports. Despite being fortunately located between the world's fastest growing and potentially largest economies, the shares of China, India, and ASEAN in its exports are only 0.8 percent, 1.9 percent, and 1.5 percent, respectively. Bangladesh is not making the most of the growth of the Asian giants. Exports have been boosted by duty-free access to Australia, Canada, China, the EU, Japan, and Norway. The United States suspended the GSP facility provided to Bangladesh on June 2013. However, the GSP facility did not provide duty-free access for some key Bangladesh exports, and only a few goods qualified under the U.S. GSP. Only 0.62 percent of the country's goods exported to the United States qualify under this system (WTO 2012). As a result, import duties on Bangladesh exports to the United States amounted to US\$732 million in 2012.⁴. At present, 96 percent of Bangladesh's exports to the United States consist of readymade garments and textile products, which are bought by retail groups such as Walmart, Gap, and Target.

Source: UNCOMTRADE.

 $^{^{3}}$ The products are (i) T-shirts, singlets, and other vests, HS code 6109; (ii) jerseys, pullovers, cardigans, etc., HS code 6110; (iii) men's suits, jackets, trousers, and shorts, HS code 6203; (iv) women's suits, jackets, skirts, and shorts, HS code 6204; and (v) men's shirts, HS code 6205.

⁴ United States International Trade Commission database.



Figure 1.5: Number of Exported Products, Bangladesh and Comparators, 2011

Source: Authors

Note: The x markers represent particular countries. Bangladesh is at the intersection of the dotted lines.

1.17 However, garments are not a single category of exports, and if treated separately, Bangladesh is actually more diversified than most comparators. As highlighted in Cadot, Carrère, and Strauss-Kahn (2011), export concentration follows a U-shape path as a function of the level of development (as measured by PPP⁵ income per capita). Poor countries start out very concentrated, then diversify, and then—beyond about US\$25,000—re-concentrate. As shown by the Theil's concentration index⁶ in figure 1.6, Bangladesh's exports has been de-concentrating—diversifying—rapidly over the years, so that it is now clearly below the regression curve describing "average" concentration at each level of income. Bangladesh exports a range of garment products, whereas many countries at the same level of income export a single primary product. Note that t-shirts, trousers, and swimsuits (all garments) are the "same type" of export, but they represent a type of diversification, as their prices are imperfectly correlated (for instance, knitwear and woven are typically not the same product). Thus, the concentration in a range of products all belonging to the RMG category does not expose Bangladesh to the single-price fluctuations that exporters of primary products face.

⁵ PPP = purchasing power parity

⁶ Theil's concentration index is an alternative to Gini or Herfindahl indices. It is more flexible in that it can be decomposed into additive group components, a useful property in the context of export diversification.



Figure 1.6: Export Concentration, Bangladesh and Comparators

Note: Calculations use COMTRADE mirrored export data. Concentration is measured by Theil's index at HS6.

1.18 Bangladesh's export patterns have little changed over time, indicating a lack of dynamic churning. First, the same products have dominated the market over the decade. This is a striking difference from more vibrant economies, for which the top five products are seldom the same over a decade, with a substantial churning of top export earners over time. For example, in China only one of the top five products in 1998 was still among the top five in 2008. Second, Bangladesh has very low export growth of old products in new markets. The decomposition of Bangladesh's export growth between the intensive and extensive margins shows that this is mostly explained by an increase in exports of old products in old markets (table 1.1). The contribution of this component in Bangladesh is particularly high compared to peer countries.

2.2 Persistent Low Sophistication of Exports

1.19 The sophistication of Bangladesh's export basket has also stagnated over time. The level of "sophistication" of products appears to matter for economic growth. According to Hausman, Hwang, and Rodrik (2007), countries that have a more sophisticated export basket enjoy accelerated subsequent growth while those with less sophisticated export baskets tend to lag behind. The data for Bangladesh and selected peer countries shows that the sophistication of Bangladesh's export basket is comparable to that of Pakistan despite a lower per capita income (figure 1.7). However, it has stagnated between 2002 and 2008, whereas India's and China's have increased over time. According to Lall's classification, Bangladesh's exports are heavily concentrated in the low-tech space, representing more than 90 percent of total exports of goods (other LDCs export primary and resource-based products). This reflects the concentration of Bangladesh's exports at the lower end of textiles and clothing sector, despite the sector being very differentiated. An assessment of the relative quality (relative unit values) of textile exports to the EU shows that Bangladesh's increased market share in the EU market is associated with a decrease in the average unit price of products relative to the unit prices other exporters charge for the same type of products. Vietnam, another leading garment exporter has been able to significantly increase its share of high tech exports since the mid-2000s (figure 1.7.d and box 1.1).

Source: Data from Cadot, Carrère, and Strauss-Kahn (2011).

1.20 Nonetheless, there appears to be diversification potential in different goods, but despite starts, Bangladesh has not yet achieved scale in products other than garments. The product space literature (see box 1.2 and figure 2.5) confirms that Bangladesh's strengths are still centered around the garments and footwear cluster, and that exports of bicycles and ships, for example, are in the periphery. While a number of export products have emerged, and some, such as jute products and frozen foods, have become quite large, the dominance of garments continues, with their share of total exports going up further, from 74 percent to 79 percent between FY05 and FY12. Moreover, even a large labor-intensive cluster has not yet emerged: jute goods were less than 3 percent, and leather 1.4 percent, of total exports in FY12. However, because footwear is in the dominant cluster, the product space literature would suggest that it could grow. By contrast, Vietnam seems to have been able to consolidate its garment exports and increase the share of higher value products (box 1.1).

1.21 Bangladesh has reinforced its revealed comparative advantage in garments, located at the periphery of the forest. Figure 1.8 shows the product space for Bangladesh in 1990 and 2010, indicating the sectors in which Bangladesh has acquired or lost revealed comparative advantage (RCA)⁷ over time (outlined and colored dots indicate exports with a RCA higher than 1), and provides a glimpse of the pace of structural transformation in the economy. Bangladesh's product space of 1990 is relatively similar to its 2010 one, with not much movement along the product space (e.g., from garments to machinery or electronics, which are more knowledge intensive). Bangladesh did increase the number of products (defined at SITC 4 digits) with RCA higher than 1 from 47 in 1990 to 65 in 2010, mostly garment and textile products.

Figure 1.7: Export Sophistication--Bangladesh and Comparators





c. Technological content of Bangladesh's exports



b. Textiles and clothing, change in market share

⁷ The concept of RCA can be defined very simply, Balassa's (1965) measure of relative export performance by country and industry, defined as a country's share of world exports of a good divided by its share of total world exports. The index for country i good j is RCAij = 100(Xij / Xwj)/(Xit / Xwt) where Xab is exports by country *a* (*w*=world) of good *b* (*t*=total for all goods). An RCA index above 1.0 indicates that a country's share of exports in a sector exceeds the global export share of the same product.



Source: World Bank.

Note: EXPY refers to is a measure of the level of sophistication of the export basket of a given country (see Haussman et al. (2006). Panel (b) shows market shares and relative quality from the average between 1996-1998 to the average between 2006 and 2008. Circles in panel (b) represent products defined as 6-digits HS codes.

Box 1.1: Vietnam Has Increased its Export Basket Sophistication and Market Diversification

Vietnam has consolidated its labor-intensive manufacturing exports while increasing the share of high-tech products. Vietnam traditional labor-intensive manufacturing exports such as garments, footwear and furniture continue to sustain rapid growth. A noteworthy addition to the export basket has been the exports of hi-tech and high value products (e.g., cell phones and parts, computers, electronics and accessories, automobile parts), that have emerged as the largest and fastest growing export items in 2012. Vietnam exported \$12.7 billion worth of cell-phones and accessories in 2012, compared to \$3.7 billion of rice, \$6.1 billion of seafood and \$7.3 billion of footwear. In 2013, exports of cell phones and accessories are expected to exceed \$18 billion, overtaking garments as the largest export item from Vietnam.

Vietnam's top three markets represent less than 50% of export markets. Vietnam's top three export markets in 2012 were Europe, the US and Japan, accounting for 46 percent of its exports, down from 46 percent in 2002. The modest decline in the share of exports going to advanced countries has been captured by its neighbors, namely China and ASEAN. Given that South-South trade is increasing at 1.5 times the rate of growth of North-South trade, it is important for Vietnam to continue to diversify its export destinations and explore new markets in Africa, South Asia and Latin America.

The composition of Vietnam's imports has changed, largely reflecting the changes in its exports basket and move to a more high-tech industrial landscape. The share of machinery and equipment, petroleum products, textile materials, plastics, and motor vehicles in total import value has gradually fallen, while the share of high-tech intermediate products has increased nearly five times—from 3 percent of the total import bill in 2002 to 16 percent in 2012 (figure 12). The share of many other items such as agricultural materials, metals and chemicals in total imports has remained unchanged in the last one decade.

Vietnam's imports from China have significantly increased, while shares of other countries in the import bill have commensurately declined. Vietnam imported one-quarter of its import needs from China in 2012, compared to only 11 percent in 2002. This trend is similar to what we observe in many other developing countries, where China has gradually displaced advanced economies to emerge as their primary trading partner. This process has been facilitated by growing intra-enterprise trade by multi-national companies, a dramatic decline in logistics costs and the move to increasingly form efficient global supply chains. The rise of Chinese share in Vietnam's imports has meant a smaller share for most other countries, but mostly by Japan, EU, and ASEAN countries.

Political and economic reforms (Doi Moi) launched in 1986 have transformed Vietnam from one of the poorest countries in the world, with per capita income below \$100, to a lower middle income country within a quarter of a century with per capita income of \$1,130 by the end of 2010. The ratio of population in poverty has fallen from 58 percent in 1993 to 14.5 percent in 2008, and most indicators of welfare have improved. Vietnam has already attained five of its ten original Millennium Development Goal targets and is well on the way to attaining two more by 2015.

Vietnam's success story was driven by economic and social transformation from a centrally-planned to a more market-oriented economy. Vietnam, like China, started with de-collectivizing land usage and adopted a gradualist approach to state-owned sector (SOE) reforms, at the same time as it opened up to foreign trade and investment. Vietnam's trade- and FDI-friendly policies since the introduction of reforms have made a noteworthy contribution to its success in export development. At the same time, the termination of the US embargo in 1992, and the enactment of the US-Vietnam bilateral trade agreement in 2000 all contributed to accelerating Vietnam's integration into the world market. Today, Vietnam is a much more open economy, with total trade (exports plus imports) growing to 160% of GDP in 2010, compared with merely 19 percent 20 years ago. Productivity increase has been an important source of Vietnam's economic growth, along with capital accumulation and labor input increases. The Socio-Economic Development (particularly skills for modern industry and innovation), (ii) improving market institutions, and (iii) infrastructure development. The overall goal is for Vietnam to lay the foundations for a modern, industrialized society by 2020.

Source: World Bank 2013.



Figure 1.8: What Bangladesh, Sri Lanka, and Vietnam Export: Product Space 1990 and 2010

Note: Colors indicate different sectors; outlined circles indicate exports with RCA higher than 1.

1.22 The location of garment at the periphery of the product space indicates that moving to another sector would require different capabilities than those used for garments. Interestingly, the two products with the highest RCA are processed raw jute and woven jute woven. The product space for Vietnam reveals how Vietnam has caught up with and surpassed Bangladesh over the same period. Starting with around the same level of exports as Bangladesh in 1990, Vietnam exported four times more than Bangladesh in 2010. It expanded its garment exports but also built capabilities in new products such as electric wire, furniture, electronics, and machinery. Sri Lanka, another garment exporter in the region, was able to maintain its competitiveness in garment and strengthen its global competitiveness in chemicals and medical instruments, as well as foodstuffs (figure 1.1). Malaysia was able to diversify away from garments over the same period, and improved its competitiveness in electronics, and chemicals and medical instruments, a denser area of the forest.

1.23 For Bangladesh, South-South trade provides some opportunities for export diversification. Bangladesh currently exports standard products that can easily be sold in other emerging countries with more dynamic and growing economies and middle class. Moreover, Bangladeshi locally produced goods, even those that would not meet the requirements of high income countries with stringent standards, could be exported more easily to neighboring countries with similar consumers' habits. In fact, Bangladesh's exports to other low-income countries are more diversified than to high-income ones. This is shown in figure 1.9, which plots the average factor intensity of Bangladesh's exports per destination country against the destination country's income level. There is much more factor variation at low-income levels than at high-income ones, indicating more variety in the factor content of Bangladesh's exports to low-income countries. Moreover, gravity estimates⁸ suggest the existence of untapped potential to increase exports to large and proximate markets such as China, India, and Pakistan. The respective shares of China, India, and ASEAN in Bangladesh's total exports are 0.8 percent, 1.9 percent, and 1.5 percent.





Source: Calculations based on UNCTAD's revealed factor intensity database and UN COMTRADE (mirrored data). Note: In panel (a), the vertical axis measures the average capital intensity of Bangladesh's exports, in thousands of U.S. dollars per worker, by destination country, whereas the horizontal axis measures the income level of destination countries, in thousands of U.S. dollars per capita. In panel (b), the vertical axis measures the average human-capital intensity of Bangladesh's exports, in average years of schooling per worker. The horizontal axis is the same as panel (a).

⁸ In trade, the gravity model presumes that distance (proxy for actual shipping cost, policy barriers, and informational asymmetry) and mass (GDPs of exporting and importing countries) explain a large share of bilateral trade. One can gauge whether a country is underexporting to a destination country of interest by comparing actual export values in a given year with a predicted export value obtained from a regression that controls for the standard gravity variables such as absolute bilateral distance, GDP, and per capita incomes.

2.3 Garments Can Still Drive Future Growth

1.24 The garment sector can continue to grow for the following reasons. First, international experience suggests that there is an income threshold before per capita garment exports start to decline, and this threshold could come at a per capita income level of between US\$1,500 and US\$2000 (in constant 2000 U.S. dollars). Bangladesh appears to have some distance to traverse before hitting this threshold. It could continue to grow in basic garments, its core strength, and then sustain garment growth by moving to medium and higher-end garments. This is represented in figure 1.10: per capita garment export growth is sustained by moving away from basic garments, and the decline in per capita basic garments exports (point A) must occur before the overall decline in per capita garment exports (point B) (see World Bank 2012a for details). Second, and this reinforces the point above, recent research shows that growth of firms within a sector generates externalities for other firms in terms of recognition, information, and access to credit (Cadot et al. 2011). This "brand recognition" and sector synergies for Bangladesh in garments will help it to reinforce its growing dominance in the sector, wherein growth could come through quality upgrading and backward/forward linkages. Third, there is the search for other production destinations as China's growth in wages leads to its gradual shift away from very labor-intensive production. Bangladesh, already the second largest RMG exporter in the world, with 4.8 percent of the market, continues to grow, and there are signs that Japanese retailers, which have hitherto mostly sourced from China and Vietnam, are starting to source more of their textiles and garments from Bangladesh (WTO 2012). All this implies that continued garment growth is sustainable in the foreseeable future, including through "vertical diversification" to allow Bangladesh to slowly move away from low-end positioning and allow greater increases in unit values (Lopez-Acevedo and Robertson 2012). In turn, the increase in unit values will allow wage increases, which could contribute to the domestic economy's diversification through demand effects.



Figure 1.10. Per Capita Income Threshold for Export of Garments

Source: World Bank 2012(a).

1.25 However, labor issues (i.e., wages, workplace safety, and compliance with labor standards) can generate major reputational risk for Bangladesh's overall garment exports, and will need to be carefully managed. Labor standards and safety issues can affect future exports and Bangladesh's overall reputation in the exporting sector. Concerns have been heightened recently following a series of fatal incidents, and the Government has been pressured to take a number of measures to improve workers' safety. International buyers and governments have also reacted strongly to these events (box 1.2). The US suspended GSP trade privileges for Bangladesh over concerns about safety problems and labor rights violations in the garment industry on June 27, 2013. Whatever measures the government will implement under domestic and international pressure, the important issue will be enforcement and commitment to ensure better and safer practices. Continued improvement in labor conditions in the garment sector, in coordination with international business and development partners, would be important. The aim would be to ensure workers' safety, improve consumers' welfare, and to maximize the demographic dividend.

Box 1.2: Will the Collapse of Rana Plaza Create a Wave of Far-Reaching Reforms?

The fallout from the April 24 collapse of the 8-storey Rana Plaza multipurpose building in Savar, Dhaka, has had domestic and international repercussions. The death toll exceeded 1,100, mostly female garment workers who worked in the upper floors of the building in several garment factories supplying about 30 Western clothing retailers. Early analysis suggests that the building was not built to code; was not fit to sustain the additional weight of the three highest floors added after the original building was built; and was not suited to carry the weight of people and equipment that a garment factory requires or withstand the vibrations of the back-up generators that were installed in the upper-floor factories. A few people have been jailed for complicity in this situation, including the building owner and some factory owners (who urged factory workers to return to their work places a day after large cracks were found in the building and a structural engineer pronounced the building to be unfit for use), and others have been suspended, including public officials who authorized the building's construction.

In the meantime, international clothing retailers which source products in Bangladesh as well as the European Union (which has given Bangladesh preferred trader status for garments) are re-evaluating their ties to Bangladesh. On July 8, 2013, a mostly European consortium of 70 retailers and apparel brands has agreed on a legally binding plan to inspect within nine months all Bangladeshi garment factories that supply the companies. Among the few American companies that have joined the European-dominated plan are PVH, Abercrombie & Fitch and Sean John. To allow for inspections, the Western retailers agreed to send in the names and addresses of all the Bangladeshi factories they import from, by July 15. In an unusual move, the list of these factories, expected to total nearly 1,000, will be made public, as will the inspection reports. Companies often resist disclosing the names of their overseas suppliers for fear of competitors stealing them⁹.

Two days later, seventeen American retailers, which have formed the Alliance for Bangladesh Worker Safety, have announced their non-binding initiative developed with the help of the Bipartisan Policy Center to improve factory safety in the Bangladeshi garment industry¹⁰. It calls for inspections of 100 percent of alliance member factories within the first year; common safety standards to be developed within the next three months; inspections results that are transparently shared; and that all alliance factories actively support the democratic election and successful operation of Worker Participation Committees (WPC) at each factory. Members of the alliance are providing the funding necessary over the five-year period—currently at \$42 million and growing—to support the specific programs of the initiative, with some companies offering an additional combined total of over \$100 million in loans and access to capital to assist factory owners they work with in Bangladesh for factory safety improvements.

At least one American company--Disney--has decided to "cut-and-run" rather than to "stay-and-improve."¹¹ If others follow Disney's lead, the impact on Bangladesh's garment industry, which accounts for about almost 80% of export earnings, and therefore on its GDP, could be very significant. Under pressure to respond to the Savar tragedy, the GoB has pledged to raise garment workers' minimum wages, improve factory safety standards, expand inspections, and improve worker rights to form unions and bargain collectively. A new Labor Law was passed by Parliament on July 15, 2013; its contents are being reviewed.

Source: Authors

3 Dependence on Imports

1.26 For developing countries, exports are not only important for their well-established static and dynamic gains (scale economies, competition, knowledge transfer, etc.). Exports are also a main source of foreign currency necessary to finance the import of capital goods and other inputs. Indeed, the gains to trade are as much derived from imports as from exports—openness to imports also acts as a disciplining force on domestic markets, leading to lower cost, higher-quality inputs and intermediate goods for producers. Access to a variety of products also encourages innovation and technological change. The smooth flow of imports is particularly critical for exporters who need to be competitive globally and are

⁹ http://www.nytimes.com/2013/07/08/business/global/clothiers-in-deal-for-inspecting-bangladeshi-factories.html ¹⁰http://www.nytimes.com/2013/06/28/business/us-to-suspend-trade-privileges-with-bangladesh-officialssay.html?hp&_r=0;

http://az204679.vo.msecnd.net/media/documents/bangladesh-alliance-press-release_130179348070616796.pdf

¹¹ Disney's decision was actually taken before the Savar building collapse, in response to a fire which killed 262 garment workers in another garment factory in Tazreen in Nov. 2012; Disney also explained that Bangladesh's low ranking in the Worldwide Governance Indicators, partly drove this decision.

constantly competing with other players. Imports need to flow smoothly both to support the import needs of the export sectors and the needs of the domestic population. Imports benefit consumers by decreasing prices and increasing product variety. Services imports have also become a pillar of countries' export competitiveness agenda by making services, as input to the industry, more efficient and cost effective.

1.27 Bangladesh imports critical and necessary inputs. A large share of imports is geared towards the export sector. About half of imports are from the category Consumer and Intermediate Goods, of which about 80 percent are intermediate goods (30 percent petroleum) (figures 1.11 and 1.12). Consumer goods represent no more than 20 percent of total imports, partly reflecting a protected consumer domestic market (see Chapter 2 on Trade Policy). Capital goods represented a third of imports in 2011. While the share of machinery has declined over time, the share of iron and steel and "other capital goods" has increased in recent years. Even as exports have risen significantly, imports have been rising even faster, resulting in a chronic and widening trade deficit that has been offset by strong remittance inflows from Bangladeshi overseas workers.

1.28 Bangladesh depends on Asia for much of its imports. In FY 2010/11, Asia's share in its total goods imports was 64.4 percent, including China (17.6 percent), India (13.6 percent), Singapore and Japan (nearly 4 percent each), and other Asian countries (24 percent). Imports from the EU and North America combined accounted for only 14.7 percent of the total value of imports.



Figure 1.11: Bangladeshi Imports by Broad Category, FY 1990/91 to FY 2010/11 (percent)

Source: Calculations using data from Statistics Department, Bangladesh Bank.



Figure 1.12: Bangladesh's Imports of Consumers and Intermediate Goods in 2011

Source: Calculations using data from Statistics Department, Bangladesh Bank.

4 Exporting Firms' Performance and Dynamics

1.29 The Trade Outcomes Analysis uses the decomposition of the margins of trade growth as a framework for exploring trade competitiveness, as outlined in figure 1.13. It is based on firm-level customs transaction data analysis and will shed some light on firm-level dynamics. The analysis will focus on three main aspects: a) exporters' characteristics: average size, number of products exported, number of markets covered, etc.; b) exporters' dynamics and survival; entry, exit and survival rates; and c) exporters' growth patterns: exporters' average growth rates by industry, by market, growth in exports of "new" vs. "old" products/markets, etc. The analysis will also compare exporters in Bangladesh with those in other countries using a World Bank dataset with data for more than 45 developing countries. Note that firm level results may sometimes seem inconsistent with broader published data, but this is not the case. For example, even if on average, Bangladeshi firms export to more destinations than say country X, this is quite consistent with country X overall exporting to more countries (firms could have non-overlapping exporting destinations) and having a more diversified market base.



Figure 1.13: Decomposition of Export Growth—A Framework for Measuring Trade Competitiveness

Source: World Bank 2012 - Trade Competitiveness Diagnostics Toolkit

1.30 The Bangladesh database includes 7,305 exporting firms on average with an average export level per exporter of US\$2.5 million over 2008–11 (table 1.3). By comparison, Cambodia, a smaller economy, had an average 618 exporters over 2008-09, with average exports of US\$ 5.2 million per exporter. Chile has a comparable number of exporters, 7,314, exporting US\$8.3 million on average per exporter. Bangladesh has experienced growth in both the extensive (number of exporters) and the intensive (average exporter size) margins. However, while the Bangladeshi exporter base has grown at a relatively steady pace (especially in the most recent years), average exporter size has displayed faster growth over the period 2005-2011.

1.31 A large number of Bangladeshi exporting firms export several products. Exporting firms in Bangladesh export on average about four products to four markets (figure 1.14).¹² Many Bangladeshi exporting firms grow and diversify across both products and destinations, although other firms of all sizes remain focused, often on a single product or single destination (figure 1.15). Market diversification has increased between 2005 and 2011. From serving about 3 markets on average in 2005, the average exporter in Bangladesh served about 4 markets in 2011. Bangladesh also shows one of the smallest differences between average and median size of exporters, indicating a less skewed (more even) size distribution of exporters. The skewness in the exporter size distribution in Bangladesh is, however, increasing over time (a large difference indicates that one very large exporter or a group of very large exporters coexist with a mass of very small exporters).

¹² Products are defined at a disaggregated level, from customs data.

	Annual averages										
		Number of	Number of	Average	Median	Share top	Ave. Nr.	Ave. Nr.	Entry		1st-year
Country	Period	exporters	entrants	exporter size	exporter	1%	Pdts per	Dest per	rate	Exit rate	survival
		exporters			size	exporters	exporter	exporter			rate
Bangladesh	2008 - 2011	7,305	1,924	2,484,106	280,915	21%	4.33	4.09	26%	22%	59%
Cambodia	2008 - 2009	618	201	5,158,033	498,441	15%	7.53	5.10	32%	30%	56%
Ethiopia	2010 - 2012	2,041	657	1,139,086	107,904	33%	3.41	2.32	33%	36%	51%
Lesotho	2012	1,486		980,655	1,348	75%	6.66	1.40			
Nepal	2010 - 2011	2,231	606	395,277	32,987	47%	3.19	2.53	27%	25%	
Pakistan	2008 - 2010	15,628	4,035	1,201,998	61,540	41%	5.13	3.26	26%	24%	56%
Romania	2008 - 2011	10,530	3,343	4,357,966	233,239	53%	7.22	2.95	32%	29%	49%
Turkey	2008 - 2010	46,999	13,826	2,278,580	117,831		10.18	4.11	29%	28%	55%

Table 1.3: Key Descriptive Statistics on Exporters in Bangladesh and Comparators

Figure 1.14. Diversification of Bangladeshi Exporting Firms, 2008–12



Source: Exporter Dynamics Database, World Bank (http://econ.worldbank.org/exporter-dynamics-database). *Note:* Countries sorted by GDP per capita. ETH: Ethiopia; NPL: Nepal; BGD: Bangladesh; KHM: Cambodia; PAK: Pakistan; ROU: Romania; and TUR: Turkey.



Figure 1.15: Firm-Level Concentration across Bangladeshi Products and Destinations, 2011

Source: Calculations using Bangladesh NBR data.

Note: The horizontal axis measures the log of a firm's total export sales in 2011, in BDT (ranging up to 10 billion, or about US\$120 million). The vertical axis measures the Herfindahl index of concentration across HS6 products (LHS) and destinations (RHS). The Herfindahl index is the sum of the squares of product or destination shares. It is equal to one for single-product or single-destination firms.

1.32 The decomposition of Bangladesh's export growth between the intensive and extensive margins shows that most of the export growth is explained by the increase of exports of old products in old markets as in most countries (table 1.4). The contribution of this component in Bangladesh is particularly high compared to peer countries. Bangladesh's performance is more modest when it comes to growth of old products in new markets, or growth of new products in old and new markets, reinforcing the observation of sluggish export diversification across products and markets. However, relatively speaking, old products do better in new markets compared to newer products emerging in either old or new markets.

Margin	Components of export growth	BGD	IND	PAK	LKA
Intensive					
Margin	Increase of old products in old markets	263.2	100.6	110.4	120.1
	Decrease of old products in old markets	-159.9	-58.1	-70.4	-83.4
	Extinction of exports of existing products to				
	existing markets	-29.9	-19.2	-33.2	-24.5
Extensive					
Margin	Increase of new products in new markets	0.1	0.0	0.1	0.0
	Increase of new products in old markets	5.6	0.0	1.7	5.4
	Increase of old products in new markets	20.9	10.0	24.8	15.6

Table 1.4:	Comparative	Decomposition	of Export	Growth	(2008-2012))
					(,

Note: BGD: Bangladesh; IND: India; PAK: Pakistan; LKA: Sri Lanka; the decomposition is first computed on a year-by-year basis over 2008-12, and then averaged for the period.

1.33 Analysis of exporters from 38 developing countries available in the Exporters Dynamics Database (box 1.3) indicates that total exports are often dominated by large multiproduct, multidestination exporters, but these form a small share of the number of exporters. In particular, exporters selling more than four products to more than four markets account for 60 percent of exports on average (64 percent in Bangladesh), but only for 13 percent of the number of exporters, on average, across all countries. The

latter numbers vary from about 3.5 percent in Albania and Botswana to 21.5 percent in South Africa, 22.4 percent in Bangladesh, and 29.4 percent in Cambodia (Cebeci et al. 2012).

Box 1.3: The Exporter Dynamics Database

The Exporter Dynamics Database includes exporter characteristics and measures of exporter growth based on firm-level customs information from 38 developing and 7 developed countries, primarily for the period 2003 to 2010. Pooling across the datasets for all countries allows 15 million unique observations at the levels of country, firm, product, destination, and year. This raw dataset is used to construct the database.

The measures are available at different levels of aggregation, including country-year, country-year-product, and country-yeardestination. Several new stylized facts about exporter behavior across countries emerge from the database: (i) Larger or more developed economies have more exporters, larger and more diversified exporters, and lower entry and exit rates than smaller or developing economies. (ii) In the short run, expansions along the intensive margin (exporter size) contribute more to export growth than expansions along the extensive margin (number of exporters). (iii) Exit rates are highly correlated with entry rates and both are negatively correlated with survival rates, average exporter size, and diversification. (iv) The number of exporters and the entry and exit rates in a country-product group are partially driven by country and product-group effects; however, the average size of exporters in a country-product group is not.

Although the first three facts can be explained by models incorporating firm heterogeneity and uncertainty, the fourth fact is more difficult to explain with existing models. Several findings are confirmed in this database, including the importance of large multiproduct firms. This database can be a valuable tool to improve the understanding of the microfoundations of export growth, by providing new insights about exporter characteristics and dynamics.

The figures included in this report (figures 1.14 to 1.17) contain information for some countries that currently are not included in the first version of the Database (Ethiopia, Nepal, Lesotho and Romania). The information for these countries will be added and released as part of the second (expanded) version of the database (January 2014).

Source: Cebeci et al. 2012.

1.34 Firms exporting fewer products are the biggest exporters. Diversification has not necessarily been an engine of fast growth for Bangladeshi firms, as big export surges (20-fold or more export sales growth over a five-year period) tend to be associated with single-product or at least heavily concentrated firms. Figure 1.16 shows that single-product firms (the first bar in the graph) saw their exports multiply, on average, by 10 over the five-year period between FY 2006/07 and FY 2010/11. Firms with two products performed well, but the growth was just over two-fold. Average growth reduced as the number of products rose, reaching 14 percent (cumulatively over the five-year period) for firms with 30 products.¹³ This trend is common across countries, with expansions along the intensive margin (increases in the average exporter size) contributing more to export growth in the short run than expansions along the extensive margin (increases in the number of exporters). This evidence supports a trade model with heterogeneous firms along the lines of Melitz (2003) where entrants into export markets tend to be marginal firms that have little impact on total exports. Moreover, firms face fixed costs to export each product and serve each market. Only more capable firms are able to generate variable profits to cover those fixed costs and thus supply a wider range of products to each market.

¹³ This is not just a convergence effect: A regression controlling for initial export sales still returns a negative and significant coefficient on the initial number of products.


Figure 1.16: Growth Factor of Bangladeshi Firms, FY 2010/11 over FY 2006/07, as a Function of Number of Products

Note: Bar height measures the ratio of average export sales in 2010–11 over 2006–07 (two-year averaging after converting NBR data to calendar-year format was used to reduce the incidence of misreporting). The number on the horizontal axis is the number of products in 2006–07. Growth is in BDT, which depreciated by 5 percent relative to the U.S. dollar over the period.

1.35 Few new exporting firms are entering the market in Bangladesh given its level of income. The entry and exit rates in Bangladesh are below 25 percent, much lower than the average and median for developing countries at around 37 percent (figure 1.17). Entry rates range from 22 percent in Brazil to more than 50 percent in Malawi and Yemen while exit rates range from 22 percent in Bangladesh to 61 percent in Malawi. Less churning usually takes place in more sophisticated export markets, where there are a lot of firms that sell a wider range of goods to more markets (Cebeci et al. 2012). In Bangladesh, it may reflect the maturity and concentration of the RMG sector, with limited diversification taking place.

1.36 Average entry rates in Bangladesh (26 percent) are lower than those observed on average in comparator countries (figure 1.17).¹⁴ This pattern is surprising considering recent evidence that shows that relatively lower churning in exporting is normally observed in larger-sized and more developed economies (Cebeci et al. 2012).¹⁵ However, it is worth noting that the lower churning observed in Bangladesh may reflect the maturity and concentration observed in its garment sector.

Source: Calculations using Bangladesh NBR data.

¹⁴ The group of comparator countries was selected based on the following criteria: a) countries within the same geographical region (Nepal and Pakistan), b) countries with similar leading sector (Ethiopia) and c) countries in the Exporter Dynamic Database with a large manufacturing base and high export growth in the past decade (Cambodia, Lesotho, Romania and Turkey).

¹⁵ Trial and error or entry and exit of exporters is less frequent in developed economies where exporting firms are more mature and closer to their steady state equilibrium (Cebeci et al. 2012)



Figure 1.17: Dynamics of Bangladeshi Exporters and Comparators 2008–2012

Source: World Bank Exporter Dynamics Database ((http://econ.worldbank.org/exporter-dynamics-database). *Note:* Countries sorted by GDP per capita (descending order). ETH: Ethiopia; NPL: Nepal; BGD: Bangladesh; KHM: Cambodia; PAK: Pakistan; ROU: Romania; and TUR: Turkey.

1.37 Related to lack of churn is the survival rate of entrants in the first year in Bangladesh, which is better than in competing countries. Survival rates of new entrants into export markets have no clear correlation with the level of development (Cebeci et al. 2012). The better survival rate reflects the larger number of survivors among the entrants coupled with the lower rate of new entry (figure 1.17). First-year survival rates of new exporters vary between 23 percent in Cameroon and 61 percent in Bangladesh. The low survival rates across countries suggest an extremely high attrition rate of new entrants after just one year in export markets, particularly in Africa. However, that is not a defining characteristic of less-developed countries, since high attrition rates of new entrants are also observed in Spain and Estonia.

1.38 Given the distribution of exporter size, an export-promotion program targeting small and medium enterprises (SMEs) is unlikely to change the country's aggregate export performance. The distribution of total export values across Bangladeshi's export firms is also very concentrated, with the top 1 percent and the top 5 percent accounting for over a quarter and over a half of total exports respectively, over the period 2008-2011.¹⁶ However this applies to most of the countries where data is available, and Bangladesh has in fact a more even distribution of exporters by size than some comparator countries.¹⁷ The distribution of exporter sizes in Bangladesh implies that the effect of export-promotion schemes targeting small exporters will not have a significant impact on overall export performance.¹⁸ A reasonable

¹⁶ Calculated from firm level export data collected from NBR.

¹⁷ Bangladesh has the smallest difference between average- and median-size exporters, indicating more even size distribution of exporters. The group of comparator countries was selected based on the following criteria: a) countries within the same geographical region (Nepal and Pakistan), b) countries with similar leading sectors (Ethiopia), and c) countries in the Exporter Dynamic Database with a large manufacturing base and high export growth in the past decade (Cambodia, Lesotho, Romania and Turkey).

¹⁸ According to a benchmark calculation, an export promotion scheme targeting 1,000 SMEs could hope to raise exports by about US\$11.2 million a year.

objective for such a program would be to nurture "export entrepreneurs" (such as potential exporters), some of whom may, over the long run, turn small-scale success into a large-scale business. Export promotion can be used as a tool to help reorient Bangladeshi exporters to faster-growing markets, as recent research suggests that export-promotion agencies are typically better at promoting entry into new markets than any other form of export expansion (Cadot et al. 2011).

1.39 Linking the above analysis with the competitiveness challenges as described in figure 1.18 suggest the important potential to improve the trade performance at the extensive margin by essentially penetrating new markets and exporting new products, through diversification and quality upgradation. Finally, the low entry and exit rates suggest competitiveness challenges most likely are driven by weaknesses in the general export environment. Overall, the analysis suggests that there is potential to intensify exports based on the existing factor endowment (large pool of unskilled labor)—i.e existing exports can grow significantly, both in current and new markets. Data suggests that Bangladesh will have to work harder to produce another large, labor-intensive cluster like garments, but its export presence in a wide variety of manufactured products indicates that it is possible, with the right supporting environment and with skill upgradation.



Figure 1.18: Linking Trade Outcome Categories to Competitiveness Challenges

Source: World Bank 2012.

5 Bangladesh's Trade in Services

1.40 Trade in services, particularly business services, has become a dynamic component of trade as well as another source of export diversification in developing countries. During 2000–07, trade in services grew as fast as trade in goods, at an average rate of 12 percent per year. India's success is well known: Exports of software and business process services account for approximately 33 percent of India's total exports. Brazil, Costa Rica, and Uruguay export professional and information technology–related services; Mexico exports communication and distribution services; Chile exports distribution and transportation services. African countries are also participating. Morocco, Tunisia, Kenya, and South Africa provide professional services to Europe, and Arab Republic of Egypt has developed a world-class call center sector. Health services are successfully exported by the Philippines and Thailand.

1.41 Bangladesh's services exports have trebled over the past decade, from a little over US\$800 million in 2000 to around US\$2.4 billion in 2010.¹⁹ As highlighted in table 1.5, the contribution of

¹⁹ http://unctadstat.unctad.org (accessed on April 23, 2012).

traditional services such as transport and travel has declined over the decades from around 50 percent to about 20 percent of total services exports. The contribution of other services—in particular, communications, other business services, and, to some extent, computer and information services—has grown over this period. In value terms, other business services constitute the largest segment within other services. They grew almost six-fold in value and increased their share in total services exports by around a third between 2000 and 2010. Likewise, communication services grew more than ten-fold in value terms over this period. Bangladesh's move towards new services reflects partial liberalization of subsectors such as information and communication services and business services exports reflects the impact of deregulation in services such as telecommunications. The growth in other business services (including engineering, consulting, and other professional services) reflects Bangladesh's large pool of manpower and growing opportunities in emerging services such as skill-intensive and professional services.

Table 1.5: Value (US\$ million) and Share (perc	ent) of Exports for Different Service Subsectors in
Bangladesh, 2000, 2005, and 2010	

	2000		2005		2010	
Subsector	Value	Share	Value	Share	Value	Share
Commercial services	283.192	100.00	474.21	100.00	1,209.41	100.00
Transport	91.368	32.26	113.009	23.83	173.591	14.35
Travel	50.421	17.80	70.009	14.76	81.221	6.72
Other commercial services	141.403	49.93	291.192	61.41	954.598	78.93
Communications	21.532	7.60	23.906	5.04	277.67	22.96
Construction	0.194	0.07	14.156	2.99	6.909	0.57
Insurance	3.513	1.24	5.027	1.06	6.841	0.57
Financial services	13.083	4.62	17.972	3.79	40.841	3.38
Computer and information	3.243	1.15	18.713	3.95	37.756	3.12
Royalties and license fees	0.058	0.02	0.261	0.06	0.517	0.04
Other business services	99.253	35.05	210.013	44.29	582.147	48.13
Personal, cultural and recreational services	0.527	0.19	1.144	0.24	1.925	0.16

Source: UNCTADstat database (http://unctadstat.unctad.org/), accessed on April 23, 2012.

Note: The shares in the above table have been calculated after excluding "Government services n.i.e."

1.42 Bangladesh's low growth in tourism exports and poor ranking in this segment are noteworthy. It suggests constraints related to infrastructure and connectivity as well as possible lack of focus on developing this sector for exports. The low value of computer and information services exports (the relatively fast growth over 2000–10 was due to a low base value) is also striking, given the growing demand for software services in the global market and the emergence of other LDC exporters of computer services. It suggests that Bangladesh, notwithstanding its potential in labor-based and skill-intensive business services, has not been able to fully leverage its potential in this segment and could be facing competition from other low-cost LDC exporters of IT and IT-enabled services.

1.43 Bangladesh's services imports have also registered a considerable increase over the past decade, from US\$1.6 billion in 2000 to US\$4.4 billion in 2010 (table 1.6). In contrast to its services exports, however, the share of traditional services such as transport has actually increased, more than tripling from US\$1 billion in 2000 to US\$3.4 billion in 2010 and its share of total services imports has risen from 66

percent to over 80 percent over this period.²⁰ This growing dependence on imports of transport services in part reflects the demand from the RMG sector and Bangladesh's reliance on foreign transport carriers, given its capacity constraints in transport and logistics. There has also been a more than trebling of imports of other business services in value terms, reflecting the growing importance of these supporting services to the economy. However, both in value and share, transport services dwarf all other segments.

	2000		2005		2010	
	Value	Share	Value	Share	Value	Share
Commercial services	1,523.35	100.00	2,011.36	100.00	4,128.30	100.00
Transport	1,012.76	66.48	1,544.73	76.80	3,440.64	83.34
Travel	289.91	19.03	136.27	6.77	260.60	6.31
Other commercial services	220.68	14.49	330.36	16.42	427.06	10.34
Communications	7.39	0.48	20.62	1.03	20.23	0.49
Construction	2.15	0.14	1.07	0.05	6.29	0.15
Insurance	91.07	5.98	150.65	7.49	26.32	0.64
Financial services	30.75	2.02	13.27	0.66	45.35	1.10
Computer and information	1.52	0.10	4.26	0.21	5.42	0.13
Royalties and license fees	4.42	0.29	2.75	0.14	17.64	0.43
Other business services	83.29	5.47	137.72	6.85	305.70	7.40
Personal, cultural and recreational services	0.10	0.01	0.03	0.00	0.13	0.00

Table 1.6: Value (Million US\$) and Share (Percent) of Imports for Different Service Subsectors in Bangladesh, Selected Years

Source: UNCTADstat database (http://unctadstat.unctad.org/), accessed on April 23, 2012.

Note: The shares in the above table have been calculated after excluding "Government services n.i.e."

1.44 Bangladesh has had a persistent trade deficit in services, which has grown from around US\$800 million to nearly US\$2 billion in the past decade. This deficit is concentrated in traditional services such as transport and travel; there is a positive trade balance in other commercial services, on account of emerging segments such as communications and other business services. In terms of global rankings of countries, Bangladesh ranks at 107 as a service exporter, though its rank is higher in the case of "other commercial services" exports, owing to the category of other business services (table 1.3). Bangladesh ranks among the top 100 service-importing countries, primarily on account of its import dependence in transport services.

1.45 These service trade figures clearly highlight two important points: First, Bangladesh is potentially more competitive in nontraditional services that rely on information and communication technology and availability of competitive labor, in services which have been liberalized (although the potential in computer and information services appears to be unrealized till date). Second, at present Bangladesh appears to be less competitive in traditional services such as transport and travel. One reason is because infrastructure availability and supply capacity are critical for delivery of these services. Furthermore, there is need for further liberalization and policy reforms or for greater policy thrust to promote exports (as argued in various studies regarding the country's infrastructure and logistics services sectors, as well as in this chapter). The growth trends in different services segments similarly confirm the growing and likely potential in some emerging services.

²⁰ http://unctadstat.unctad.org (accessed on April 23, 2012).

1.46 The revealed comparative advantage (RCA) indices from the UNCTADstat database for Bangladesh's services exports also highlight that the country is relatively competitive in communication and other business services. The latter have RCAs of 1 or more while RCAs for transport and travel services have consistently been less than 1 and declined over the past few years (table 1.7). The RCA values as well as the shifts in composition of the services export basket suggest that Bangladesh's traditional exports are affected by domestic constraints arising from inadequate infrastructure and lack of supportive policies. The decline in the RCA value for computer and information services, notwithstanding the skill-intensive nature of this segment, is noteworthy, especially against the much higher RCA for other business services and for communication services. As noted earlier, it is indicative of the country's untapped potential in this segment due to domestic and external factors (see chapter 15 on IT-enabled services).

	2000	2005	2010
Other business services	1.9169	2.3415	1.9037
Communications services	4.1406	4.9121	10.1303
Transportation	0.6545	0.5509	0.6728
Travel	0.5007	0.3342	0.2634
Financial services	0.5516	0.4356	0.4672
Computer and information services	1.1188	0.6385	0.5342
Construction services	1.5859	0.3002	0.2229
Insurance services	0.6064	0.5641	0.2475
Personal, cultural, and recreational services	0.3334	0.1110	0.1111
Royalties and license fees	0.0092	0.0002	0.0066

Table 1.7: Revealed Comparative Advantage in Bangladeshi Services, Selected Years

Source: UNCTADstat database (http://unctadstat.unctad.org/), accessed on April 23, 2012.

1.47 Bangladesh's overall RCA for services exports has been below 1 and stagnant through the past decade in contrast with its RCA for goods. The country has also registered higher growth in goods as opposed to services exports over the past two decades. This is also reflected at the regional level, where Bangladesh's export performance in goods has been superior to that in services, as also highlighted in figure 1.19. Its share in world services exports has risen only marginally from 0.05 percent in 1990 to 0.06 percent in 2010, compared to an increase in its world share of goods exports from 0.05 percent in 1990 to 0.12 percent in 2010. The share of services exports in Bangladesh's total exports has remained at around 11 percent over the past decade, lower than for the other big countries in South Asia, while the share of services imports in its total imports has been in the range of 15 to 18 percent.





Source: UNCTADstat database (http://unctadstat.unctad.org/), accessed on April 23, 2012.

6 Exports of Labor Services²¹

Source: BMET.

1.48 Bangladesh is an important source of largely semiskilled and unskilled migrant workers to selected countries. Data on overseas employment provided by the Bureau of Manpower Employment and Training (BMET) of Bangladesh highlight the rising trend in overseas employment of Bangladeshi workers over the past three decades, from around 200,000 workers in 2000 to 600,000 workers in 2012, with female workers constituting about 6.1 percent of all migrant workers in 2012 (figure 1.20). The main destination markets are the Middle East, the United States, and the United Kingdom and Southeast Asia (table 1.8). These also constitute the main source countries for remittances. Saudi Arabia alone accounts for nearly one-third of the total stock of Bangladeshi migrant workers.

Figure 1.20: Overseas Employment of Bangladeshi Workers, 1976–2012



²¹ See Chapter 16 on opportunities and challenges for services exports for a more detailed discussion on export of labor.

Country	Number of migrants ^a	Share of total migration (%)
Saudi Arabia	2,046,736	31.1
United Arab Emirates	1,542,376	23.5
Malaysia	553,789	8.4
United Kingdom	379,716	5.8
United States	298,067	4.5
Oman	281,105	4.3
Kuwait	260,013	4.0
Singapore	223,677	3.4
Qatar	154,309	2.3
Bahrain	149,698	2.3

Table 1.8: Top 10 Destination Countries of Bangladeshi Migrants, 2000–10

Source: Calculated from BMET data.

Note: a. Number of migrants up to June 2010.

1.49 Corresponding to the rise in overseas employment, there has also been a very considerable increase in remittance inflows, from less than US\$1 billion in the 1990s to nearly US\$2 billion in 2000 and to more than US\$14 billion in 2012 (figure 1.21). The significance of labor services exports is evident from the increase the share of remittances in Bangladesh's GDP from 4.1 percent in FY 1999/2000 to 11.1 percent in FY 2012/13. Bangladesh is ranked 8th among the top 10 remittance recipients in the world (World Bank 2012c). These large inflows of remittances have macroeconomic and developmental implications for Bangladesh's economy (see World Bank 2012b). Studies indicate a strong multiplier effect of these remittances in the rural areas of Bangladesh. Effects include increased consumption spending and increased investment on health and education relative to nonmigrant families, and the establishment of enterprises and small businesses by returnee migrants or their family members, which are generating employment and creating markets for locally produced goods and services (Raihan et al. 2009). Thus the management of migration and associated remittances is an important issue for Bangladesh.

Figure 1.21: Remittances Earned by Bangladeshi Migrants, 1976–2012 (US\$ million)



Source: BMET.

1.50 Bangladesh's mode 4 exports are dominated by low-skilled workers, followed by skilled and semiskilled workers, according to government sources. This movement is mostly in the form of contract labor. Table 1.9 highlights the categorization of Bangladesh's labor exports by skill. It highlights the declining trend in professional manpower exports and the significant rise in low-skilled labor exports, which are mainly in occupations such as domestic work, construction (masonry), and transport operations; and manual trades such as carpentry, fabrication, welding, and cleaning.

	Category						
Year	Professional	Skilled	Semiskilled	Low-skilled	Total		
1990	6,004	35,613	20,792	41,405	103,814		
2000	5,940	42,742	30,702	109,581	188,965		
2005	1,945	113,655	24,546	112,556	252,702		
2012 (up to December)	812	209,368	20,498	377,120	607,798		

Table 1.9: Breakdown	of Bangladeshi	Overseas Workers	by Skill	. 1990-2012
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Source: BMET.

1.51 There is also limited skill movement from Bangladesh to English-speaking developed countries such as the Australia, the United Kingdom, and the United States. These numbers are quite small in comparison with the large number of low-skilled workers working worldwide, particularly in the Middle East and relative to larger countries in South Asia (figure 1.22 shows that remittances are dominated by Bangladeshis in the Middle East). As per the U.S. Department of Homeland Security data for 2009, there were a mere 389 persons engaged on H-1B visas and 46 on L-1 visas from Bangladesh, even lower than the number of Sri Lankans working under these categories in the United States (U.S. Department of Homeland Security 2009). Similarly, in the case of the United Kingdom, the number of applications under the Highly Skilled Migrant Program has been quite small, 200 or less for most years (Salt 2006). Overall, the overseas employment data for Bangladesh suggest a comparative advantage in less-skilled labor services exports, a concentration of market access interests in the Middle East, possible domestic and external constraints to increasing professional services exports, as well as a potential to diversify in terms of both markets and skill categories.

Figure 1.22: Remittances Earned by Bangladeshi Migrants by Country, 2012 (US\$ million)



Source: Bangladesh Bank.

7 Conclusion

1.52 Bangladesh's exports have performed impressively. Bangladesh's exports doubled their world market share between 1995 and 2012, owing to the success in garments, catering largely to the EU and USA. Since 2009, it has become the world second largest garment exporter, making it unique amongst LDCs in its high share of manufactures in total exports.

1.53 The above analysis suggests that there is a great potential to intensify exports based on the existing factor endowment (large pool of unskilled labor) but also the scope to improve factor endowments to diversify, move up the value chain and produce more sophisticated goods and in a more productive way.

1.54 Future export growth will likely rely first on capturing new markets with existing products. Garments can continue to grow, in existing and newer markets. Newer products will emerge more slowly. Thus, more rapid export growth will initially rely on capturing higher market shares in Bangladesh's existing strengths, i.e., basic garments--both in current markets, and penetrating newer and dynamic markets such as Japan, China, ASEAN and India. Other products are emerging, such as jute goods, footwear, sea food, information technology enabled services (ITES), etc., and some of these may over time become part of a larger product cluster.

1.55 Bangladesh will need to focus more attention to skills development and workers' welfare to enable. The low level of literacy and years of schooling of the labor force make skill acquisition more difficult. According to the latest World Bank Poverty Assessment (2013), just a third of the primary graduates acquire the numeracy and literacy skills they are expected to master by the time they graduate. Moreover, among the labor force the percentage of persons having professional education such as engineering and medicine is very small (only 0.17% of the labor force has such degrees). Skills are emerging as a major constraint, even in the garments sector, let alone other, more skill-intensive sectors. A World Bank survey of 1000 garment firms in 2011 found that skills were the major disadvantage if firms located outside Dhaka. High rejection rates in a 2010 UNIDO survey also point to low average skills of garment workers. In sectors such as ITES, shipbuilding and pharmaceuticals, part of this DTIS, higher skills were in constant demand (World Bank 2012a, 2012b).

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CHAPTER 2

Trade Policy, Export Incentives, and Consumer Welfare

1 Introduction

2.1 In Bangladesh, the government's development program aims to use trade policy as an instrument for generating export expansion and diversification. The broad trade-policy objectives are consistent with the Vision 2021 development strategy, which aims at raising the country's growth rate to 10 percent per year within the next five years. This is to be achieved through an array of policies, including the following:

- Enhanced access to imported capital equipment and raw materials through tailored adjustments to the import regime
- Infant-industry protection for targeted sectors
- Fiscal incentives for users of foreign technology
- Export promotion and encouragement to quality upgrading in the ready-made garments (RMG) sector
- Reinforcement of standardization and quality-control capabilities

2.2 Trade policy has served Bangladesh well so far, resulting in sustained export growth. Dollar exports have doubled over the last six years. Bangladesh is now the second biggest exporter of garments, and could benefit significantly from China's rising wages and the ongoing move to cheaper garment producers. Also, Bangladesh has an unusually high share (at its income level) of manufactured exports in its export basket, which illustrates its strengths in mass manufacturing and labor availability. The economy has become increasingly open, fuelled by a trade policy environment more conducive to exports. Trade policy reform included a substantial scaling down and rationalization of tariffs, major reductions of quantitative restrictions and import licensing, unification of exchange rates, and the move to a managed float exchange rate regime.

2.3 Yet, significant inconsistencies stemming from lingering trade protectionism for some industries, along with a focus on revenue targets, raises questions about the overall efficacy of trade policy and sustainability of export growth. Trade policy often responds to protectionist pressures, reminiscent of the import-substituting trade regime that prevailed before the 1990s. Revenue and/or protectionist considerations have usually dominated over trade policy issues. Thus, trade policy in Bangladesh been skewed, where consumers and export sectors other than garments have not been conscious beneficiaries of such policies. Moreover, in recent years, border taxes have increased and grown more complex, and have led to high and varied rates of effective protection. Overall, the trade policy regime has translated into reduced incentives to export and diversify, and has led to higher domestic prices.

2.4 Trade policy design and implementation is also challenged by lack of coordination among responsible agencies. The principal responsibility of domestic and international trade in Bangladesh rests with the Ministry of Commerce (MoC). The Imports and Exports (Control) Act of 1950 empowers the MoC to regulate the import and export of goods and services, which it carries out through a periodic Import Policy Order that encompasses a range of non-tariff barriers (such as quotas, import controls,

licensing) and Export Policy that provides for incentives and other schemes. In addition, the MoC is the focal point for bilateral, multilateral and regional negotiations and for ensuring Bangladesh's compliance with WTO Agreements including dumping, safeguards and countervailing duties. In practice, the Ministry of Finance, through the National Board of Revenue, takes the lead role in tariff-setting in Bangladesh, and the Ministry of Industries also offers a range of incentives under its industrial policy. In reality, trade policy formulation includes fragmented elements that are not necessarily implemented coherently in the pursuit of a common Vision (see chapter 4 for a broader discussion on Institutional Capacity in Bangladesh).

2.5 This chapter discusses the different aspects of trade policy that the government needs to address. We use, among other sources, novel customs transaction data and a detailed firm-level survey of effective protection in 100 firms. The analysis focuses on tariffs and fiscal revenues, nontariff measures, related welfare issues, quality standards, and services trade restrictiveness. It will analyze the extent to which trade policy has been trade and welfare enhancing. This also implies that any protectionist measures should be justified in terms of economy-wide positive spillovers and should also be temporary. Since much of the analysis is comparative, Bangladesh also needs to keep in mind the more harmonized trade policies in export-competing countries, such as Indonesia Vietnam, and others.

2 Heavy Border Taxation

2.6 This section look at border taxation, which increases the cost of inputs and intermediate goods, thereby increasing domestic production cost; it also raises the price of consumer goods, hurting the poor and the urban middle income class. Tariffs and para-tariffs also tend to restrict product variety in the domestic market, and limit the scope for producing new products and impacts consumer welfare. Relatively high average tariffs introduce an anti-export bias into the trade regime because they make it more attractive for companies to produce for the protected domestic market rather than to sell overseas.

2.7 The tax treatment of imports in Bangladesh is complex. Average Customs Duties (CD) have come down over the past decade from 70.6 percent in FY92 to 13.2 percent in FY14 (figures 2.1 and 2.2).¹ One of the key features of tariff reform was the move towards uniformity: from about 20 tariff slabs, the tariff structure now is divided into four non-zero slabs of 2, 5, 10, and 25. The system presents low tariffs of 2-5 percent for basic raw materials and capital goods, 10 percent for intermediate goods, and the top rate of 25 percent for final goods. CDs have increased by 6 percentage points since FY09, increasing the average protection in FY10-12 compared to the previous three years. The proliferation of other duties and taxes has added to the increase in the average protection rate. It also has become a burden for both importers and the customs administration. The resultant increase in complexity and reduction in transparency raises the chances of errors and inefficiency, and provides more opportunities for lobbying and rent-seeking.

2.8 A proliferation of para-tariffs has resulted in a complex import tax regime and substantially increased the rate of border protection (Figure 2.1).**Error! Reference source not found.** Para-tariffs— import taxes and levies other than custom duties—have slowly emerged as a dominant set of trade taxes since the middle of the past decade (box 2.1). Supplementary duty (SD) and regulatory duty (RD) seem to have become standard instruments for raising revenue or offering protection to domestic import substituting industries. Such tariff changes that raise overall protection and also increase its dispersion across products potentially set back the agenda for trade diversification. The combination of the tariff rate with para-tariff rates gives an average nominal protection rate (NPR) of 27.3 percent in FY14, up from 20.1 percent in FY09 (albeit with a decline in FY14, compared to the 28.9 percent rate of FY13).

¹ The import-weighted average is 10.3 percent.



Figure 2.1: Overall Protective Rate: Downward Trend but Para Tariffs Hike in Recent Years

Source: Tariff Data from different policy order; *Note* Para tariff: Regulatory Duty (RD) + Infrastructure Development Surcharge (IDSC) + License Fee (LF) + Protective Supplementary Duty (SD) + Protective Value Added Tax (VAT); Overall Protective Tariff: Customs Duty (CD) + Regulatory Duty (RD) + Infrastructure Development Surcharge (IDSC) + License Fee (LF) + Protective Supplementary Duty (SD) + Protective Value Added Tax (VAT)

Figure 2.2: Tariffs and Para-tariffs Paid by Companies in Bangladesh as Percent of CIF Values, 2012



Source: Calculations using NBR data.

Note: For each tax, the weighted rate is the ratio of total taxes paid to total CIF import value from firm-level data; the unweighted rate is the simple average of this ratio calculated at the firm level; the nominal rate is the official rate on the books. AIT: advanced income tax; ATV: advanced trade VAT (a tax levied nominally at 3 percent of the VAT inclusive price of commercially imported goods); CD: customs duty; PSI: pre-shipment inspection; RD: regulatory duty; SD: supplementary duty.

2.9 Para-tariffs are not trade neutral. The RD of 5 percent was introduced in FY 2000/01 and is levied on imports only. Though an SD was introduced in 1991 under the VAT Act and was meant to be a tradeneutral tax, it has been increasingly applied in a non-neutral fashion; it is not applied equally on imports and domestic sales, following exemptions issued through statutory regulatory orders (SROs) by the National Board of Revenue (NBR). In principle, SDs are aimed at discouraging the import of luxury goods, and goods considered undesirable on social or moral grounds. Bangladesh applies SD rates of 350 percent on "sin goods" (alcohols and tobacco) and rates up to 156 percent on automobiles, depending on their type. However, in practice, SDs have been used as a tool to levy additional tariffs on a range of goods, as and when deemed appropriate by the authorities, including on raw materials and intermediate goods (WTO 2012). A substantial number of other products carry SD rates of 60 percent. While punitive rates on alcohol and tobacco can easily be justified by negative externalities, and high rates on luxury cars on redistribution grounds, extensive use of SD at 60 percent, including on a number of hygiene and consumption goods, is less justified. It does seem that a large share of the SDs has no obvious welfare justification.

Box 2.1: Bangladesh's Para-tariffs

Apart from Customs Duties (CDs), Bangladesh customs authorities impose a number of levies, taxes and fees on imports, which are therefore defined as para-tariffs. Customs duty is the only recognized "customs tariff" for cross-country comparisons. CDs are charged under the Customs Act, 1969. The revenue authorities grant some special exemptions on the statutory rate of CD for certain commodities through statutory regulatory orders (SROs). Duty is charged on an *ad valorem* basis as a percentage of "assessable value" of imports.

The different para-tariffs are:

Regulatory duty (RD). An RD is levied at a flat rate of 5 percent of assessable value. It was introduced in FY 2000/01 and is levied only on imports. It is an import-specific tax, levied on annual basis, that is a customs tariff under a different name.

Supplementary duty (SD). An SD is levied on items listed under the VAT Act, 1991. The rate depends on the product. The VAT authority also issues exemptions on SDs through the SROs. In the beginning, SDs were charged according to "assessable value"; but from FY 1997/98, SDs have been levied on the basis of duty-paid value (assessable value plus customs duty plus regulatory duty).

Value-added tax (VAT). The VAT was introduced in 1991 in place of the Excise and Salt Tax Act, 1944. VAT is a trade neutral tax applied at a uniform rate of 15% on imports and domestic production. However, the entire group of textile products, though subject to 15% import VAT, is exempt from VAT on domestic production, except for a levy of 2.5%. This non-uniform application of VAT on textiles has protective implications and serves as a para-tariff as well. Advance income tax (AIT). The AIT is collected under the Income Tax Act and levied at a flat rate of 5 percent on assessable value of imports, with a corresponding adjustment when the taxpayer settles his yearly income tax. Some exemptions are given via SROs. However, becomes a potential para-tariff when, in practice, AIT ends up to be a final settlement as it seems to be often the case on most if not all imports.

Advance trade VAT (ATV). The ATV is applied only on commercial imports – commodities imported for retail sale. ATV is levied at a flat rate of 3 percent on "VAT paid value" (assessable value plus effective VAT).

Pre-shipment inspection (PSI) agent fee. The PSI agent fee is collected under the Customs Act and PSI rules and levied at a flat rate of 1 percent on assessable value at the imports stage.

Agent advance income tax (ITC). The ITC is collected under the Income Tax Act and levied at a flat rate of 5 percent on chargeable commission (considering the C&F agent charges 1 percent commission on assessable value as their operating fee; from that fee the 5 percent AIT is charged at source).

Source: Authors

2.10 The level of border protection is also high when compared to other low income economies and assessed using alternative measures of the overall stance of Bangladesh's border-tax structure.

Bangladesh tariffs, excluding para-tariffs for which we do not have comparable data across countries, remain amongst the highest in the region. Average Most Favorite Nation is about 12 percent for LDCs and 9 percent for Lower Middle Income Countries (figure 2.3). Also, simple-average tariffs are known to be biased, giving too much weight to small items. Weighted-average tariffs underestimate the true rate of restrictiveness of the border-tax structure because high tariffs reduce imports and hence the weight of items to which they apply. Two alternatives have been widely used: The Tariff Trade Restrictiveness Index (TTRI) and the Overall Trade Restrictiveness Index (OTRI).² Based on customs duty rates only for FY 2010/11, the TTRI for Bangladesh is 13.8 percent and OTRI is 10.4 percent. A recalculation of the TTRI and OTRI taking into account all para-tariff charges gives 38.9 percent for the TTRI and 28.4 percent for the OTRI. The TTRI has a higher value because of high rates of the SD in Bangladesh, which get magnified in the TTRI's formula (which involves the square of the protection rate). Recalculating TTRI after capping the import-discriminatory component of the SD at 60 percent, the TTRI goes down only marginally, to 36 percent.



Figure 2.3: Average Tariffs Below 15 Percent in Most Low Income Countries, 2012 (percent)

Source: TRAINS database (Data for Bangladesh is not available).

3 Distortionary Incentives

2.11 Consumer goods are overly protected in Bangladesh, and there is a growing wedge between input and output tariffs. The government levies significant SD and RD on top of the 25 percent tariff for final goods, mostly on products that are produced domestically and are not taxed as much (table 2.1). Thus tariff escalation is the highest at the last stage of processing—from intermediate goods to final goods. The wedge between the average nominal protection rate on inputs and final consumer goods has been rising

$$TTRI = \sqrt{\frac{\sum_{k} \varepsilon_{k} M_{k} t_{k}^{2}}{\sum_{k} \varepsilon_{k} M_{k}}} \text{ OTRI} = \frac{\sum_{k} \varepsilon_{k} M_{k} t_{k}}{\sum_{k} \varepsilon_{k} M_{k}} \text{ TTRI} = \sqrt{\frac{\sum_{k} \varepsilon_{k} M_{k} t_{k}^{2}}{\sum_{k} \varepsilon_{k} M_{k}}} \text{ OTRI} = \frac{\sum_{k} \varepsilon_{k} M_{k} t_{k}}{\sum_{k} \varepsilon_{k} M_{k}}$$

 $^{^{2}}$ The TTRI is the uniform tariff rate that would entail the *same deadweight losses* as the current array of border taxes at different rates. The OTRI is the uniform tariff rate that would entail the *same level of imports* (all products together) as the current array of border taxes at different rates. TTRI and OTRI formulas are as follows:

where k is imported products, ε is the price elasticity of import demand, M is the value of imports in dollars, and t is the compound rate of all border taxes.

since FY 2008/09 (figure 2.4), and appears designed to offer higher protection to domestic industries primarily engaged in consumer goods production. Tariff escalation appears to be the outcome of prebudget consultations with producer groups only, without consultation with other stakeholders such as consumers who could suffer welfare losses through higher prices or reduced choice.

2.12 There has been no critical evaluation of the impact of protection. In general, higher tariffs on a product encourage its domestic production and discourage exports, since the former is protected by the tariff and the latter is a far more competitive marketplace. The low protection for intermediate and capital goods arguably discourages domestic production of these goods; and high protection for consumer goods encourages domestic production. If there is no 'sunset clause' or expiration date for protection, and the impact of protection on the protected sector and the rest of the economy is not evaluated, as is the case in Bangladesh, this can lead to economic inefficiencies.

	Domestic stage					
	E-SD	E-VAT	CD+RD	P-SD	P-VAT	P-Total
Basic Raw Materials	0.55	9.17	9.58	2.69	1.55	13.82
Intermediate Goods	0.09	15.34	12.36	2.48	0.45	15.29
Capital Goods	0.04	9.95	6.08	3.13	0.36	9.56
Final Consumer Goods	4.08	14	23.36	20.82	4.35	48.53
Total	1.71	13.21	15.21	10.01	2.07	27.29

Table 2.1: Imported Consumer Goods Are Heavily Taxes Compared to Local Production, FY2013/14

Source:



Figure 2.4: Average Tariff on Import categories FY 00/12



Table 2.2: Tariffs and Para-tariffs in Bangladesh as Share of CIF Value, by Sector, FY 2010/11 (percent)

							Other (PSI,	
Sector		CD	SD	VAT	AIT	ATV	ITC, RD)	Total rate
01-05	Animal & Animal Products	7.1	1.9	14.6	4.6	0.7	2.8	33.7
06-15	Vegetable Products	1.4	1.0	4.4	0.4	0.0	0.1	7.5
16-24	Foodstuffs	2.7	1.8	2.5	0.6	0.6	0.4	8.8
25-27	Mineral Products	9.9	0.2	15.2	1.7	2.5	0.2	29.7
28-38	Chemicals & Allied Industries	3.1	0.6	5.6	2.0	0.6	0.4	12.4
39-40	Plastics/Rubbers	8.2	1.3	14.6	3.5	1.5	0.9	30.1
41-43	Raw Hides, Skins, Leather, & Furs	18.7	17.6	16.8	4.8	4.0	3.1	66.1
44-49	Wood & Wood Products	8.8	1.4	8.3	3.1	0.8	1.1	24.2
50-59	Textile	0.8	0.5	0.9	0.2	0.2	0.9	2.8
60-63	Garment	24.3	20.4	22.0	4.7	5.1	3.0	82.2
64-67	Footwear/Headgear	24.9	27.7	23.6	5.0	5.2	3.6	92.3
68-71	Stone/Glass	19.2	26.4	21.1	4.5	4.4	2.8	79.7
72-83	Metals	8.0	0.4	10.5	2.8	1.0	0.7	23.5
84-85	Machinery/Electrical	5.1	1.2	2.7	0.6	1.0	0.4	11.0
86-89	Transportation	11.0	12.5	10.4	2.1	2.3	0.9	40.1
90-97	Miscellaneous	7.3	2.8	6.5	2.0	2.1	1.0	21.7

Source: Calculations using NBR data.

Note: Data excludes companies operating under the bonded warehouse system. AIT: advanced income tax; ATV: advanced trade VAT (a tax levied nominally at 3 percent of the VAT inclusive price of commercially imported goods); CD: customs duty; ITC: advance income tax; PSI: pre-shipment inspection; RD: regulatory duty; SD: supplementary duty.

2.13 Border taxation varies substantially at the sector level for both tariffs and para-tariffs (figure 2.5).³ Border taxation rates vary substantially between and also *within* sectors, potentially reinforcing distortions to individual decisions, opportunities for rent-seeking, and the consequent need for enforcement. In general, tariff rates are more dispersed (less concentrated) than para-tariff rates (figure 2.6), reflecting tariff escalation (see below).



Figure 2.5: Decomposition of Bangladesh's Border Taxation at the Sector Level, FY 2010/11

Source: Calculations using NBR data. AIT: advanced income tax; ATV: advanced trade VAT (a tax levied nominally at 3 percent of the VAT inclusive price of commercially imported goods); CD: customs duty; PSI: pre-shipment inspection; RD: regulatory duty; SD: supplementary duty

³ Border taxation is different from protection, since VAT is levied on both domestic and import transaction. The data illustrates the size of the tax relative to the transaction rather than the degree of discrimination between imports and domestic production.



Figure 2.6: Intra-Sectoral Concentration of Tariffs and Para-tariffs in Bangladesh, FY2010-11

Source: Calculations using NBR data.

Note: The length of bars measures the concentration of tax rates measured by Theil's concentration index. A long bar means that, within a given sector, a small number of subsectors shoulder a disproportionate share of the tax burden; a short bar means that the tax burden is spread relatively evenly within the sector.

2.14 The escalating structure of protection results in a high effective rates of protection (ERPs),4 for domestic production, which biases incentives against exports. As part of the diagnostic trade integration study (DTIS), the Dhaka-based Policy Research Institute (2012) undertook a survey of 118 manufacturing firms located in and around the cities of Dhaka and Chittagong in May–July 2012.5 The objective was to quantify the size of the distortions for firms producing selected consumer goods with potentially high ERPs (see annex A for methodological issues). The analysis confirmed especially high ERPs in sectors like footwear (214–342 percent), some agrifood products (381 percent for chira/muri), bicycles (117–386 percent), and ceramics (190–239 percent). Pharmaceuticals fall in a unique category with ERPs only modestly positive (but this is not the full picture, since competing imports are not allowed, see chapter 14). Tariffs on locally produced generic equivalents of brand-name drugs are zero or 5 percent, but a highly restrictive drugs policy prohibits imports of all drugs produced domestically. Thus, local production now meets 95 percent of domestic demand, according to a World Bank study (World Bank 2008). ERPs on drugs could actually be higher than the actual tariff, but are restrained by some price controls imposed by the Drug Administration (Drug Control Act of 1982).

2.15 By contrast, output destined for exports receives no protection, and export ERPs are typically zero when imported inputs are duty exempt via mechanisms such as duty drawback, or are exempt from duty and other import taxes altogether through special bonded warehouse (SBW) arrangements. Often, cash subsidies compensate for duty drawback or SBW (box 2.2). An exporting firm may receive cash assistance (of 10–15 percent of free on board [fob] export value) if it uses neither duty drawback nor the

⁴ The effective rate of protection (ERP) is the proportional increase in local firms' value added (or processing margin) resulting from the combined influence of tariff rates on the final good and on intermediate inputs (a pure price effect—a higher ERP does not mean that the protected good has intrinsically higher value added). An escalating tariff structure (higher rates on final goods than on intermediates) raises local value added and protection levels compared to what would prevail under a zero or uniform tariff structure.

⁵ With financial support from the World Bank, and in partnership with the local survey firm, Data International.

SBW facility. Thus, typically, ERPs for exports are expected to approach zero, be modestly positive (if receiving cash incentives), or negative if the reimbursement of duty drawback does not fully compensate for the tariff-inclusive costs of procuring imported inputs or domestic inputs that enjoy protective tariffs. Likewise, if the SBW system is effective in providing duty-free imported inputs to producers without any transaction costs, ERPs for such exports should approach zero.

2.16 With domestic market production protected at high rates, incentives to export are stifled. The bicycle industry, whose initial export drive quickly lost momentum given the asymmetry of incentives, is a case in point. Similarly, in ceramics, exports have virtually stagnated despite the industry's intrinsic strengths in terms of know-how. Given the prevailing tariffs, potential profitability in the domestic market far exceeds that in export markets, although export products are differentiated from what is sold in the domestic market. In the case of footwear, anti-export incentives have been somewhat compensated by a ban on exports of raw leather, which depresses its domestic price and provides an indirect subsidy to footwear exports but also to domestic sales. Notwithstanding the fact that such indirect subsidies are actionable under the countervailing duty regulations of the World Trade Organization (WTO), they contribute to a maze of regulatory distortions, the net effect of which is unlikely to foster economic efficiency.

Box 2.2: Three Facilities for Exporters in Bangladesh

Duty drawback system. This facility refunds duties paid on imported inputs to exporters. It enables exporters and deemed exporters to claim, within 6 months of exports, the duties and taxes paid on imported inputs used in the export process. Eligible exporters can claim their drawback by filing their claim with the Duty Exemption and Drawback Office (DEDO), which is an agency under the authority of the National Board of Revenue (NBR). Duties may be refunded in three ways: (i) actual drawback, (ii) national drawback, and (iii) flat-rate drawback. Due to fewer complications and ease of operation, the flat-rate system remains the most preferred method of refund.

Special bonded warehouse (SBW). Bonded warehouse facilities are licensed by the NBR for the deposit and storage of imported goods, mostly intermediate inputs. SBW use is usually extended to import-dependent export industries. Industries outside export processing zones (EPZs) can enjoy such facilities upon assessment and approval of the NBR. Under the SBW facility, companies can import required raw materials and can process them for re-export without import duty and with minimum customs formalities. Ready-made goods and leather industries have been the main beneficiaries of this facility, but, in recent years, other exporters, such as leather products, light engineering (bicycles), and pharmaceuticals, have been selectively given this facility. As a policy, SBW has been excluded for new exporters or smaller exporters, or for firms whose exports are not a significant proportion of total production.

Cash subsidy. Cash incentives, a method of offsetting input tariffs, are provided to import-dependent export industries that do not use either the duty drawback or the SBW schemes, but procure their inputs locally (imported or locally produced). Cash incentives, ranging from 10–15 percent, are granted on the free-on-board (FOB) value of selected exports. One concern is that this facility could be abused as there is a lot of incentive to over-invoice exports.

2.17 Distortions also arise from variations in export facilities across sectors, including SBW and cash incentives. SBWs have been mostly provided to RMG and footwear, although they are supposedly open to all exporting sectors. The facility has been selectively offered to other sectors after much red tape, as the authorities believe it is prone to abuse if given generously; hence, SBW has not become very popular. Based on the ERP firm survey, 31 out of 89 exporting firms used SBW, of which 14 were RMG accessory suppliers (deemed exporters), 11 footwear exporters, one leather products exporter, two jute textiles exporters, two bicycle exporters, and one pharmaceuticals exporter. The cash incentive scheme, originally intended to offset input tariffs, has benefited jute textile exporters significantly, though their imports (under 5 percent of output) are subject to low raw material duties. Until the end of FY 2011/12, 19 export sectors were eligible to receive cash incentives (table 2.3). In FY 2012/13, however, the number of export-oriented sectors eligible for incentives was reduced to 15 sectors. Sectors removed from the stimulus package were bicycles, poultry, finished leather, and crust leather. One of the primary reasons for removing bicycle exports was that the sector already enjoys duty-free access to its main market in the

EU.⁶ Light engineering products other than bicycles, however, would continue to be eligible for cash incentives.

2.18 The RMG sector in particular has greatly benefited from a number of incentives that were not available to other sectors, resulting in a tilted playing field (box 2.3). The success of garments has raised questions as to why no other labor-intensive sector has emerged in Bangladesh. Has government support to garments translated into fewer incentives to other potentially competitive sectors such as jute and leather based products? Beyond the availability of cheap labor, four other factors have been responsible for the success in garments: (i) technology transfer through foreign direct investment (FDI); (ii) the bonded warehouse system and back-to-back letters of credit, both initially extended exclusively to garment exporters; (iii) a high ERP with low tariffs on inputs and high tariffs on final products; and (iv) reduced tariffs in the EU and the Multi-Fibre Arrangement that imposed quotas on garment exports from Bangladesh's competitors. The current government program has extended the incentive schemes to new sectors such as shipbuilding and leather footwear.

Table 2.3: Export Promotion Cash Incentives in Bangladesh, FY 2011/12 - FY 2012/13, (% of assessed FOB export value)

	FY 2011/12	FY 2012/13	FY 2013/14
Total budget, cash incentives stimulus for exporters		US\$ 290 million	
Number of sectors receiving incentives	19	15	14
- Agricultural and Agro processed goods	20%	20%	20%
- Home Textiles	5%	5%	5%
- All textiles (incl. home textiles) exploring new markets (exc. Canada, US and EU)	2%	2%	2%
- Jute goods	10%	10%	7.5%
- Shrimp and other fishery products	10%	10%	10%
- Ships	5%	5%	5%
- Light engineering products	10%	10%	10%
- Leather products	12.5%	15%	15%
- Finisher leather	4%	0%	0%
- Crust leather	3%	0%	0%
- Poultry	15%	0%	0%
- Bicycles	15%	0%	0%

Source: Compiled by Global Development Solutions, LLC.

2.19 Against this policy backdrop, the incentives to engage in exports other than garments and one or two other sectors do not appear to be high. High and rising tariffs on consumer goods and in several other areas mean that domestic market sales could be very profitable. In addition, the wide dispersion in input and output tariffs means that there are several sectors with very high rates of ERPs for domestic sales, as opposed to ERPs for exports, which are close to zero. Also, there are variations in export incentives across sectors, with much of the de facto support going to garments and footwear. Finally, the lack of an

⁶ See chapter on bicycles for a broader discussion on the sector.

effective duty drawback or bonded warehouse system for most exporting sectors stifles the incentives for firms to search for new export possibilities.

Box 2.3: Bangladesh's Success Story: The Ready-Made Garments Sector

Bangladesh's ready-made garments (RMG) sector took off in the late 1970s through a transfer of technology and know-how from the Republic of Korea. In 1978, Korea's Daewoo, at that time an apparel producer, started collaborating with Desh, a Bangladeshi company, to upgrade its technology and management capabilities for joint apparel production in Bangladesh. Daewoo's plan was to relocate production to Bangladesh in order to escape the Multi-Fibre Arrangement's quotas, which at the time did not cover Bangladesh. By the 1980s, export growth had picked up substantially, reaching triple-digit growth in the U.S. market. In 1985, the United States slapped a quota on Bangladesh like on other Asian countries, although the quota was less constraining relative to Bangladesh's supply capabilities than it was for other Asian countries. The U.S. quota induced export redirection to the EU, where Bangladesh benefited from reduced tariffs under the Generalized System of Preferences. From the 1990s onwards, the EU became Bangladesh's premier apparel market. It has stayed that way till now.

The RMG sector's growth was encouraged by the government of Bangladesh through two primary incentive schemes:

- The bonded-warehouse system, under which 100 percent export-oriented firms in the RMG sector could import tariff free instead of waiting for duty drawbacks, which to this day have been managed by an ineffective bureaucracy
- The back-to-back letters of credit, which allow RMG exporters to obtain credit for intermediate imports using export orders as collateral

Benefiting from wages that were, and still are, among the world's lowest, flexible labor arrangements, and very light taxation (essentially an export tax levied on the free-on-board (FOB) price at a rate of 1 percent, with no corporate, profit, or payroll tax) apparel exports grew from less than 1 percent of Bangladesh's exports to over 80 percent today. The number of apparel factories grew from 134 in 1984 to 4,825 in 2009, while employment soared from 40,000 to 3.1 million over the same period.

Knitwear (t-shirts, sweaters, tank tops, and the like) have traditionally Bangladesh's dominant export to the EU market where, until 2010, rules of origin required a double transformation from yarn to fabric and from fabric to garment, meaning that fabric had to be sourced locally. The investment required for minimum efficient scale (MES) production of knitted fabric was only about US\$3.5 million, whereas for woven products (say, trousers), it could be 10 times more. As a result, Bangladesh developed an integrated value chain in knitwear, producing 80 percent of garment exporters' needs. No such integrated value chain was developed in woven wear, which limited Bangladesh's access to the EU market for woven products until the recent reform of rules of origin.

Being targeted at the low end of the market, Bangladesh's garment sector has proved resilient in the face of the ongoing global economic crisis and in fact benefited from a "Wal-Mart effect" (the substitution of low-end products for more expensive ones by cash-strapped consumers). However, in the long run, raising productivity and wages will require Bangladesh to go upmarket and improve quality and positioning.

Source: World Bank

4 Tariffs Influenced Heavily by Revenue Considerations

2.20 The good news is that Bangladesh's fiscal revenues have been increasing over the past decade, with a gradual shift from reliance on trade taxes to domestic taxes. The government's tax revenues have been rising, reaching about Tk 952 billion or 10.4 percent of GDP in FY2011/12, up from around Tk 200 billion or 9 percent a decade ago. That this has been accompanied by a decline in the share of import-based taxes is a positive development in the trade story. While import-based revenues continue to represent the largest source of tax revenue in Bangladesh, their share has declined from about 4 percent of GDP and 40 percent of revenues, to 3.5 percent and 29 percent respectively (figure 2.7). At the same time, the shares of income tax and VAT domestic have risen to 23 percent and 18 percent of revenues. In

terms of import-based revenue, NBR customs import transactions data for FY 2010/11 show that one third comes from customs and RDs, another third from VAT on imports, and the last third from paratariffs, essentially SDs (figure 2.8). Finally, as expected, intermediate and consumer goods bear the highest levels of protection.



Figure 2.7: Decline of Import-Based Tax Revenue in Bangladesh, FY 1990/91 to FY 2010/11 (percent)

Source: Calculations using NBR & Ministry of Finance.

Figure 2.8: Composition of Import-Based Fiscal Revenues in Bangladesh, FY 2010/11



Source: Authors' calculations using NBR Customs data.

Note: Customs, regulatory, and supplementary duties comprise more than 50 percent of import-based fiscal revenues.

2.21 Nevertheless, Bangladesh trade policy is still heavily influenced by considerations of revenue and assistance to local industries rather than trade competitiveness. Import policy is legally set in the Import Policy Order (IPO) issued by the Ministry of Commerce in consultation with customs. However, the NBR, which does not have export promotion as its policy goal, seems to have the final authority on tariff setting (see also chapter 4 on institutional capacity). The most recent FY 2012/13 budget offers a case in point. While CDs on intermediate goods and basic raw materials were reduced in a few cases (43 tariff lines), SDs were raised for a larger number of tariff lines (413) (Sattar 2012). According to local experts, these changes tend to be ad hoc in nature, implemented without any background research about how much and for how long protection is justified. Also, there is no obvious rationale for the variable rates of protection given to different products.

2.22 Border tax exemptions are widespread, and translate into significant revenue losses. The import tax structure is marked by a large number of exemptions of all kinds, including some that benefit single companies or under nontransparent "special order" labels. An analysis of customs transaction data at the tariff line level shows that exemptions figure in almost 30 percent of the total number of transactions and 44 percent of total trade value. These exemptions add up to significant revenue shortfalls—13 percent of collected revenue in FY 2010/11—especially in the foodstuffs sector where less than half of the nominal taxes are actually collected, as shown in table 2.4. These exemptions do not seem to be associated with heavily concentrated market structures. The highest shortfalls are in foodstuffs and chemical products, where imports are relatively unconcentrated, whereas the most concentrated importer structure is mineral products, which has very low shortfalls. The machinery sector has relatively low shortfall rates and concentration, but because of its size it accounts for almost one fourth of the total shortfall; the transportation and mineral sectors each account for another 17–18 percent of the shortfall.

Sector	Actual revenue (AR), in Tk	Revenue shortfall*, in Tk	Sector share in total shortfall (%)	Shortfall as share of AR (%)	Sector's Herfindahl index
Animal & Animal Products	1,100,000,000	28,600,000	1.2	2.6	13.94
Chemicals & Allied	6,630,000,000	4,440,000,000	7.1	67.0	10.78
Foodstuffs	2,000,000,000	3,010,000,000	2.1	150.5	7.29
Footwear	549,000,000	787,594	0.6	0.1	36.53
Garments	840,000,000	5,287,579	0.9	0.6	3.34
Machinery/Electrical	22,700,000,000	2,480,000,000	24.3	10.9	19.24
Metals	11,000,000,000	623,000,000	11.8	5.7	3.29
Mineral Products	16,500,000,000	900,000,000	17.6	5.5	110.86
Plastics/Rubbers	5,500,000,000	18,400,000	5.9	0.3	0.61
Raw Hides, Skins, Leather, & Furs	129,000,000	386,266	0.1	0.3	121.84
Stone/Glass	1,670,000,000	4,703,036	1.8	0.3	0.52
Textiles	1,730,000,000	5,415,670	1.8	0.3	0.52
Transportation	15,800,000,000	275,000,000	16.9	1.7	9.03
Vegetable Products	4,210,000,000	206,000,000	4.5	4.9	12.42
Wood	3,190,000,000	179,000,000	3.4	5.6	1.06
Miscellaneous	1,860,000,000	42,000,000	2.0	2.3	5.23
Total	93,548,000,000	12,176,580,145	n.a	n.a	n.a.

Table 2.4: Revenue Shortfall in Bangladesh due to Various Exemptions, FY 2010/11

Source: Calculations using NBR data for FY 2010/11.

*Revenue shortfalls are additional revenues collected in the absence of exemptions n.a. = not applicable.

2.23 Preferential agreements do not account for much of the shortfalls. Bangladesh is a member of the South Asian Free Trade Area (SAFTA) and Asia-Pacific Trade Agreement (APTA) (also called Bangkok agreement) and as such grants preferential treatments to other member countries. While the SAFTA agreement covers over 4,000 tariff lines (out of total of 5,369 tariff lines), the analysis of customs transactions data indicates that preferential treatment is virtually never claimed by importers (or granted by the customs). In the case of imports originating from India, only 156 out of 185,257 transactions were recorded under the SAFTA preferential treatment and 2 under the APTA agreement. For Sri Lanka, only 2 transactions benefited from the preferential treatment. In FY 2010/11, all other potential beneficiaries (SAFTA and APTA members) had their exports entering Bangladesh under the most favored nation (MFN) treatment. Apparently, the "Country of Origin" certificate is time consuming and complex to obtain and the tariff concession is very small (only 10 percent of customs duty in most cases).

2.24 In general, revenue goals are achievable with more trade-neutral border taxation. Given the magnitude of exemptions, a thorough assessment of their legitimacy would help in their rationalization and also generate revenues. A goal of much greater trade-neutrality in border taxation would be consistent with the NBR Modernization Plan (box 2.4).

Box 2.4: National Board of Revenue Modernization Plan, 2012–2016

The National Board of Revenue (NBR) is responsible for end-to-end oversight and supervision of both direct and indirect taxes. These include income taxes, VAT, and Customs. The tax base in Bangladesh is very narrow with fewer than one million income tax filers.^a Nonreporting and under-reporting of taxes affect all three taxes. The present tax information gap between what the taxpayers know and what the three tax departments know about their taxpayers is very wide. In effect, the taxes that get paid are what the taxpayer chooses to pay and not what he/she is obliged to pay under law. Tax performance in Bangladesh has been registering a steady, incremental annual improvement, with an average 20 percent growth from FY 2007/08 to FY 2010/11. However the gap between tax policy expectations and tax performance will widen in future as the government expects the three taxes to more than double revenue outturns over the next five years.

As a result, the NBR has recently undertaken an aggressive and comprehensive organizational renewal program that seeks to put in place an efficient, effective, fair, and responsive tax regime that is benchmarked against international best practice. The envisaged reform covers all the three taxes and seeks to modernize both tax policy (tax laws and statutory rules) as well as tax administration (business process, organizational design, human resource policies, taxpayer services, and so forth). One of the main goals of the reform is a significant growth in revenue performance through widening and deepening of the existing tax base across all the three taxes. With regard to customs tariffs restructuring and rationalization, a modernization of the Customs Act will aim to rationalize tariffs to promote investments, prevent misdeclarations and reduce distortions. The NBR has also embraced information and communication technology (ICT) as a key driver in its comprehensive tax administration reform effort, adopting "Digital NBR," a subset of the national program, "Digital Bangladesh."

Source: NBR.

Note: a. NBR staff informally estimates the tax collection gap at close to 5 percent of GDP.

2.25 A less distortionary tax structure could achieve the same or even higher level of revenues. Removing exemptions would increase fiscal revenues significantly.⁷ Simulation results using the World

 $^{^{7}}$ The analysis is based on import transaction data provided by the customs administration of Bangladesh for FY 2010/11. The original database includes over 1.2 million import transactions representing about 93–95 percent of total trade (some land customs stations are not yet connected to the customs computerized system), of which about 300,000 transactions were officially exempted imports (e.g., government and diplomatic imports, re-export) and were removed from the database (these imports are not affected by tariff reforms and would lower tariff averages

Bank's Tariff Reform Impact Simulation Tool (TRIST) indicate that removing tariff exemptions would increase revenues by about 7–9 percent (while reducing imports by around 1 percent), and help compensate for the reduction or removal of others taxes while inducing more economic efficiency. Another simulation capping tariff peaks at 15 percent (international peak) would induce a loss in tariff revenue between 3–7 percent. Tariff revenues would actually decline by about 20–23 percent but the induced increase in imports (between 1.7 percent and 3.2 percent) would increase the contribution of other taxes.⁸ A third simulation that removes SDs and adopts a uniform rate of 15 percent for CD+RD would increase tax revenues by 0.9 percent, which illustrates the efficiency and revenue potential of simple and uniform taxation. These simulations do not reflect changes in the production structure and consequent changes in VAT revenues on domestic production.

2.26 Economists and policy makers might not agree on the optimal level for tariffs, but establishing a uniform tariff presents several advantages, including the fact that (1) effective protection is the same for all sectors and equals the nominal protection rate; (2) it is simple, clear, and transparent, and therefore reduces business costs; (3) it reduces the cost of the customs administration; and (4) it reduces discretion (corruption). Moreover the manner in which countries reduce tariffs has important implications in terms of export incentives. Tariff-reduction schemes that exempt high tariffs or sensitive sectors could create more distortions. A strategy to reduce all tariffs—in which high tariffs are cut more than low ones—would do the most to improve export incentives and real income (Tokarick 2006).

5 Nontariff Measures

2.27 Overall, nontariff measures (NTMs) are moderately widespread in Bangladesh compared to other countries. While the analysis of NTMs has long been constrained by lack of data, the World Bank, in collaboration with the Policy Research Institute (PRI), has recently collected data on NTMs in Bangladesh as part of a global multi-agency effort to improve transparency in NTMs. An analysis of the data using two indices: the Frequency Ratio and the Coverage Ratio,⁹ and in comparison with other countries for which NTM data is available, shows that NTMs is Bangladesh cover about 50 percent of imported products defined at the Harmonized System 6-digit level (HS-6), and around 45 percent of imports.

2.28 There is a wide variation of the prevalence of NTMs across countries as illustrated in figure 2.9. In the group of selected comparators for which NTM data is available, China India, Pakistan and Sri

⁹ The Frequency Ratio simply captures the percentage of products that are subject to one or more NTMs. The Coverage Ratio captures the percentage of imports that are subject to one or more NTMs. In more formal terms, the frequency index of NTMs imposed by country j is calculated as:

$$F_j = \left[\frac{\sum D_i M_i}{\sum M_i}\right]. \ 100$$

where D_i is a dummy variable reflecting the presence of one or more NTMs and M_i indicates whether there are imports of good *i* (also a dummy variable).

A measure of the importance of NTMs in terms of overall imports is given by the Coverage Ratio. This measures the percentage of imports to country *j* subject to at least one NTM. In formal terms the Coverage Ratio is given by:

$$C_j = \left[\frac{\sum D_i V_i}{\sum V_i}\right]. \ 100$$

where, D_i is defined as before, and V_i is the value of imports in product *i*.

artificially). Imports with specific duties (no ad valorem equivalent available) and transactions with obvious recording errors representing close to 4,000 records were also removed from the database. The cleanup process left 967,548 transactions for a total import value of TK 2,135,556,832,278 (US\$30,507,954,747).

⁸ For technical reasons, taxes had to be combined because of the large number of duties and taxes in Bangladesh. The simulation removes exemptions for CD+RD and not for other duties and taxes. The 15 percent cap is for the combination of CD and RD (considered as one single duty).
⁹ The Frequency Ratio simply captures the percentage of products that are subject to one or more NTMs. The

Lanka have the highest values of frequency and coverage ratios (more than 80 percent), while Indinosia, Madagascar and South Africa haver values below 50 percent of both indicators. Bangladesh shows the intermediate level of coverage and frequency ratios. However, the correlation between the frequency and coverage ratios is not perfect: some NTMs may cover few product lines but affect large import volume, while other NTMs may cover a large number of product lines, and either do not have a significant impact on the volume of trade or are more trade restrictive.



Figure 2.9: Nontariff Measure Coverage in Bangladesh and Comparators, by Category of NTM, 2012 (percent)

Source: Calculations using PRI data.

2.29 Moreover, these indicators do not indicate whether NTMs are targeted to protect domestic industries or whether NTMs in Bangladesh are less trade restrictive than in other countries. Two factors may explain a relatively higher coverage ratio: First, import composition, especially in low income countries that often import larger volumes of products where NTMs are more extensively used (agriculture). Second, a high coverage ratio may reflect a larger use of NTMs policies on most traded products (e.g. for consumer protection), as it is often the case in developed countries. Finally, the trade restrictiveness of most NTMs can only be assessed on a case by case, depending on their justification but also their implementation procedures.

2.30 Pre-shipment inspection and para-tariffs are the two largest NTM components in Bangladesh, while sanitary and phytosanitary standards (SPS) and technical barriers to trade (TBT) are increasingly the most common NTMs across countries (figure 2.10).

2.31 Multiple NTMs on the same product increase complexity and the administrative burden. One third is not affected by any NTMs, half of the products are affected by one or two NTMs, and about 10 percent of product lines (at HS-6) are affected by more than 3 types of NTMs (figure 2.11). For example, a product could be subject to a sanitary standard (NTM category A) as well as a technical measure on quality (NTM category B), and finally to some licensing (NTM category E). Arguably, the greater the number of NTMs applied to the same product, the more regulated the commerce of that product is,

especially if measures are from different chapters and ministries.¹⁰ This suggests a source of potential inefficient domestic bureaucracy, particularly as multiple authorities are involved with the inspection and approval process. Indeed, international experience indicates that problems with NTMs often arise from lack of intragovernment coordination and burdensome bureaucratic procedures.



Figure 2.10: Nontariff Measure Coverage in Bangladesh and Comparators, 2012 (percent)

Source: Calculations using WITS database.





Source: Calculations using PRI and WITS data.

¹⁰ The rationale is that measures within the same NTM category are similar in nature and thus often impose a relatively lower burden than measures from different NTM categories.

2.32 PSI is relatively widespread in Bangladesh, affecting all sectors, about half the product lines, and two-thirds of imports (table 2.5). These levels are high compared to the average levels found in a sample of 24 developing countries, the EU and Japan, where the PSI frequency index and the coverage ratio are both about 11 percent. The relatively high incidence of PSI in low-income countries reflects the desire to fight corruption, facilitate and accelerate custom procedures, and ultimately help in the correct evaluation and taxation of imports. Although PSI is often necessary to provide some assurance on the quality/quantity of the shipment, and thus may promote international trade, it adds to the cost of trading. It is also usually implemented as a temporary measure while governments improve the technical capacity of customs. However, the Bangladeshi government has announced the end of PSI as of June 2013 (see chapter 6 for a broader discussion on PSI).

2.33 The relative incidence of technical measures (SPS and TBT) is currently limited in Bangladesh but likely to rise in the future. As tariffs have come down and the use of quantitative restrictions more monitored, SPS and TBT have become the commonest forms of NTMs in all regions. The sectoral coverage of SPS and TBT measures generally reflects the technical properties of products rather than economic policy choices. Governments are increasingly called upon to respond to a variety of concerns raised by members of society in many areas, including the environment, animal welfare, and food safety, and are urged to develop technical regulations. The incidence of technical regulations rises with the level of development. In Bangladesh, most food-related products are affected by at least one form of SPS, while TBTs are applied to a much wider set of products and more uniformly across economic sectors. Their number peaks in chemicals, vehicles, and processed food (table 2.1).

			C: Pre-	E: Quantity	F: Para-Tariff
	A: SPS	B: TBT	Shipment	controls	measures
01-05 Animal	55.7	1.3	51.0	5.4	63.1
06-15 Vegetable	4.5	5.7	23.9	2.7	17.8
16-24 Foodstuffs	18.4	12.4	31.4	18.9	31.9
25-26 Minerals		7.4	18.5		11.1
27 Oil Minerals		41.2	41.2		8.8
28-38 Chemicals	1.7	35.1	36.1	0.6	4.8
39-40 Plastic / Rubber		6.3	40.3		30.6
41-43 Hides, Skins			31.1	1.6	23.0
44-49 Wood	0.5	1.4	38.8	2.8	22.0
50-63 Textiles, Clothing	0.6	17.7	68.1	0.1	53.9
64-67 Footwear			58.3		58.3
68-71 Stone / Glass	1.7	1.7	55.7	1.7	46.0
72-83 Metals		1.9	47.3	0.9	20.4
84-85 Mach/Elec		3.3	33.8	0.1	10.6
86-89 Transportation		18.3	24.2	2.5	20.0
90-97 Miscellaneous	0.6	4.8	36.2		26.0
98-99 Special					

Table 2.5: Nontariff Measures	Coverage i	n Bangladesh	by Sector	, 2012 (percent)*
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Source: Authors' calculations and PRI data.

*Percentage of product lines covered by a given NTM (category A, B, C, E, F)

Note: SPS = sanitary and phytosanitary standards; TBT = technical barriers to trade.

2.34 Technical regulations and standards should not unnecessarily restrict trade and hurt firms' trade competitiveness. Unlike prohibitions and quotas that are easily identifiable as nontariff barriers, technical regulations may be adopted to achieve legitimate nontrade-related domestic policy objectives. Technical regulations and product standards can increase the costs of compliance in two ways. One, they can impose additional fixed costs on exporters, who have to adapt products to the specific standards and regulations applied by the importing country. Two, conformity assessment procedures, such as testing to demonstrate

^{.. =} no NTMs

compliance with these technical measures, may induce additional costs (Cadot et al. 2012). The WTO's SPS and TBT agreements contain guidance of what is regarded as international best practice in regulating quality issues, notably with respect to minimizing the trade restrictiveness of a country's quality system. The SPS and TBT agreements establish disciplines for the implementations of technical regulations and encourage and set rules for the use of trade facilitation instruments, like harmonization, equivalency, and mutual recognition. As discussed in chapter 5 on trade and standards, technical regulations should be used exclusively to regulate a narrow set of legitimate objectives.

6 Trade Policy and Welfare

2.35 High import tariffs may affect trade competitiveness and production structures, but they also affect consumers' welfare through prices In Bangladesh, the average burden of border taxation on household consumption is high, but largely progressive. Analysis using household expenditure surveys shows that tariffs add 7.5 percent to the cost of living of the median Bangladeshi household. Adding up all border taxes can increase living costs by up to 15 percent for the median household. Moreover, they seem to heavily tax middle-income households while sparing the richest. Indeed, replacing the current array of tariff and para-tariff measures by a flat combined border tax at a uniform 10 percent would raise real incomes by 11.3 percent on average—enough to lift 11.2 million people, or 7.4 percent of Bangladesh's population, above the poverty line.¹¹ While these numbers seem large, they indicate the large prevalence of imports in household expenditure baskets, as well as the high tariffs on many consumer goods (figure 2.12).

Figure 2.12: Consumption-Weighted Tariff as a Function of Household Income in Bangladesh, by Centile



Source: Calculations using Bangladeshi tariff data and Bangladesh's household survey. *Note:* Income is approximated with total consumption. For readability, the data is aggregated by centile of the distribution of income. Thus, the point to the extreme left of the diagram is the consumption-weighted tariff affecting the lowest centile of Bangladesh's income distribution. For example, given the expenditure pattern of households in that centile, they face, on average, a tariff at 6.2 percent.

¹¹ This number is a rough approximation. It is obtained by replacing the current total of tariff and para-tariff charges by a flat 10 percent combined border tax in each household's basket and calculating the reduction in expenditure needed to buy the same basket given the new tax rates. This reduction (an increase in real income) is then extrapolated to the population using data on household size and sampling weights. The last step consists of calculating the poverty headcount (the number of individuals below the national poverty line) before and after the simulation.

2.36 In addition to tariffs and NTMs, high prices on the domestic market seem to be attributable as much to a lack of competition and "natural" barriers to entry. For instance, interviews with the private sector suggest that in Bangladesh the market for edible oils is characterized by high prices, as imports are controlled by about eight large importers who have refining facilities. Controlling the high prices through parallel imports is difficult, because most edible oil sold in the countryside in Bangladesh is in "open" form (customers come with their own bottle to the store), which allows distributors to bypass packaging costs. Given the market's price sensitivity, the elimination of packaging costs makes a significant difference to the product's attractiveness. The government has traditionally attempted to alleviate the high prices during the Ramadan period by purchasing edible oil through the Trading Corporation of Bangladesh (TCB).¹² However the TCB suffers from governance problems and is not an efficient buyer, thus limiting its ability to stabilize edible oil prices as well as sugar prices, for which the market-structure issues are similar. Competition and open trade are better price stabilizers than complex state interventions, and, in addition to an easier import regime, effective operationalization of the Competition Law passed in 2012 would help to curb potential anticompetitive practices.¹³

7 Services Trade Policy Restrictiveness

2.37 Services trade restrictiveness is usually associated with low-quality, high-cost services, while openness has a positive impact on overall competitiveness, in particular on multifactor productivity growth.¹⁴ According to Arnold and others (2010), policy reforms in the services sectors played a major role in the transformation of the manufacturing sector in India, allowing greater foreign and domestic competition with improved regulation (however, despite this, the Indian services regime remains very restrictive—see figure 2.13). Available evidence suggests that the aggregate effect of services liberalization in India was an increase in productivity of 11.7 percent for domestic firms and 13.2 percent for foreign firms for a one-standard-deviation increase in the liberalization index. An illustrative set of results from the Services Trade Restrictiveness Index (STRI) database analysis suggests that services trade policies matter for investment flows and access to services. In particular, restrictions on foreign acquisitions, discrimination in licensing, restrictions on the repatriation of earnings, and lack of legal recourse all have a significant and sizable negative effect, reducing the expected value of sectoral foreign investment by US\$2.2 billion over a 7-year period, compared with "open" policy regimes.



Figure 2.13: South Asia Services Regulations Restrictiveness, 2010

Source: Borchert, Ingo, Batshur Gootiiz and Aaditya Mattoo (2011)

¹² The Trading Corporation of Bangladesh was established in 1972—right after independence—to ensure the availability of essential commodities on the domestic market through public purchases. See http://www.tcb.gov.bd. ¹³ See Helal and Taslim (2010) for a detailed analysis of the edible oils market in Bangladesh.

¹⁴ Triplett and Bosworth (2004), Inklaar, Timmer, and van Ark (2007, 2008), and van der Marel (2011).

2.38 Most countries exhibit fairly open services trade policies. The median STRI, which can range from 0 to 100, is about 24; that is, more than half of the 103 countries in the database would on average be classified as virtually open. However, some of the fastest-growing countries in Asia and the oil-rich Gulf states have among the most restrictive policies in services, whereas some of the lower-income countries, like Cambodia, Ghana, Senegal, and Mongolia, are remarkably open. While most Organisation for Economic Co-operation and Development (OECD) countries are generally quite open overall, they tend to exhibit greater restrictiveness in transportation services and the most protected in both industrial and developing countries, while retail, telecommunications, and even finance tend to be more open (Borchert et al. 2012).

2.39 In Bangladesh, services trade is more restricted than the world average, in particular in telecommunications and transportation services (figure 2.14). Bangladesh has the second most restrictive services trade policies in the South Asia region, with an average STRI of 44, well above the world average of 28.¹⁵ Bangladesh's services policy restrictiveness is most acute in telecommunications and transport services, with an STRI above 60. In telecommunications, fixed-line telecommunications is completely closed in Bangladesh, like only eight other countries (Belarus, Ethiopia, Iran, Kuwait, Mozambique, Oman, Qatar, and Zambia). In mobile telecommunications, Internet group calls and VOIP (voice over Internet protocol) are not allowed, repatriation of earnings is subject to approval by Bangladesh Bank, and 80 percent of employees must be nationals (one foreigner for every five nationals



Figure 2.14: Bangladesh Services Trade Restrictiveness by Sector

¹⁵ The World Bank Services Trade Restrictions Database contains information on policies that affect international trade in services—defined to include the supply of a service through cross-border delivery, establishment of a commercial presence, or the presence of a natural person. The database collects—and makes publicly available— comparable applied services trade policy information across a very large range of countries, sectors, and modes of delivery. To date, surveys for 79 developing countries have been collected and comparable information was obtained for 24 OECD countries. The five major services sectors covered in the database, namely financial services (banking and insurance), telecommunications, retail distribution, transportation and professional services, are further disaggregated into subsectors. The choice of sectors was based primarily on the World Bank's our assessment of their economic importance from a development perspective, on the existence of meaningful restrictions on services trade, and the feasibility of collecting relevant policy data.

is the governing ratio). In transportation, maritime auxiliary services and rail freight domestic services are completely closed; for domestic and international air passengers and domestic road freight services, the only requirements are that earnings repatriation needs approval by Bangladesh Bank, and 80 percent of employees must be nationals.

2.40 Retail and professional services are the most open in Bangladesh, but certain regulatory inconsistencies among modes of supply also prevail for professional services. In retail services, licenses must be renewed annually upon payment of a renewal fee, repatriation of earnings is also subject to approval by Bangladesh Bank, and 80 percent of employees must be nationals. Bangladesh also maintain low levels of restrictiveness for cross-border provision of professional services, but has relatively high levels of restriction on the temporary movement of professionals. Therefore, if modes of supply were perfect substitutes, this would mean that although the provision of services through the latter mode is relatively restrictive, trade would take place anyway, through the cross-border provision of the service. Generally speaking, the highest barriers to trade in both developing and industrial countries are typically observed in professional services. One reason is that for these services, the international movement of professionals (mode 4) is critical. And such movement faces two daunting barriers: immigration-related restrictions, which make entry difficult for foreigners intending to sell services, and licensing and qualification-related restrictions, which make it difficult for foreign-trained professionals to practice their professions (Bochert et al. 2012).

2.41 Lack of liberalization in some sectors is seriously constraining the quality and capacity of some services like air freight services. The monopoly of Civil Aviation is a major constraint. Bangladesh Biman provides ground handling services through a separate subsidiary that also operates the air cargo terminal. It rents space within the airport to UPS and other courier services. The three scanners owned and operated by Civil Aviation are only about 7 years old but appear to be designed for standard ocean pallets. Since they are not large enough for airfreight pallets, all shipments must be broken down prior to scanning. Civil Aviation denied the request of Biman to introduce its own scanners. It has tentatively agreed to provide new storage facilities for the cargo, but would still require the use of Biman for ground handling and Civil Aviation for scanning.

2.42 Moreover, Bangladesh has not adopted an open-skies policy that allows airlines to operate freely in the country without licensing restrictions. The Association of Travel Agents of Bangladesh (ATAB) and the main exporters are pressing for an open skies policy, which would reduce costs and provide more airfreight capacity for the garments sector. More generally, liberalization leads to increased air service levels and lower fares, which in turn stimulates additional traffic volumes and can bring about increased economic growth and employment. In South Asia region, Sri Lanka concluded a number of open skies agreements since 2005, including with the United States, Malaysia, Thailand, Singapore, and Switzerland. Open skies has been rolling out in stages in ASEAN since 2009, helping to make Southeast Asia home to the world's fastest expanding low-cost airlines. The open-skies policy essentially lifts restrictions on adding flights. Between Malaysia and Thailand, for example, each country's airlines now can make as many flights as they like to the other country, assuming there is room at the airport.

2.43 Countries with open financial and telecommunications sectors grew about 1 percentage point faster than other countries (Mattoo et al. 2006). The theoretical literature linking services liberalization to productivity increases in the broader economy is well developed (Markusen 1989, 1990; Francois 1990a, 1990b; Markusen and Venables 1998; Markusen, Rutherford, and Tarr 2005). A growing empirical literature using firm-level data and cross-country regressions also supports this relationship (Tarr 2012). The key idea is that providers of services increase the productivity of users of services in manufacturing (particularly high-tech industries and firms that use services inputs more intensively), agriculture, and in the services sectors themselves. An analysis of about 4,000 firms in India finds that services reforms in the telecommunications, insurance, and transport sectors significantly increased productivity of manufacturing firms (Arnold, Javorcik, Lipscomb, and Mattoo 2012). Fernandes and Paunov (2012) find

that linkages from FDI in services to downstream manufacturing industries account for almost 5 percent of the observed increase in Chilean manufacturing productivity growth.

As Bangladesh confronts the challenge of boosting productivity and exports, services policy reform should become a priority in the reform agenda. Many countries have taken action to increase competition in services markets by liberalizing FDI, opening access to foreign competition in backbone sectors such as transport and telecommunications, and privatizing state-owned or state-controlled service providers (Hoekman and Mattoo 2008. Liberalization of key services would help Bangladesh increase its share in the growing business process outsourcing and IT-enabled services sectors. It would also help improve the productivity of key manufacturing sectors. Liberalization can lead to enhanced competition from both domestic and foreign suppliers in sectors where barriers to entry are maintained—not only against foreign suppliers but also against new domestic suppliers, such as in telecommunications.

2.45 Productivity gains from services liberalization are more pronounced for domestic and small firms. Recent empirical studies analyzing the impact of services liberalization in Eastern Europe and Central Asia indicate that SMEs are the principal beneficiaries (Tarr 2012). This is consistent with theory, as large firms can often hire service sector specialists, like lawyers, accountants, truck drivers and courriers as employees. Small and medium size firms find full time employees too costly, and have to rely to a greater extent on the market for services. These results emphasize for policymakers the importance of services sector liberalization for the development of small and medium size domestic firms.

2.46 Areas of reforms include adopting a policy that encourages air freight services. Despite the importance of air courier services for the garments industry, in particular for shipping samples, Bangladesh, unlike its competitors, does not have a policy to encourage this service. Specifically, customs does not have de minimus (minimum weight below which there is no duty charged) to allow small packages to clear the airport quickly. The clearing process for packages and airfreight is the same, so that clearance times are 1-2 days for samples and 3-5 days for fabric, instead of a few hours for both as in most of the countries in the region.

2.47 Significant benefits would accrue to Bangladesh if positioned itself as a destination for information technology enabled services—business process outsourcing (ITES-BPO). By encouraging this sector, Bangladesh can provide direct and indirect employment to the increasing number of young people entering the job market.¹⁶ Destination ITES-BPO countries have also seen an increase in the rate of female participation in the labor force. Moreover, this sector requires low capital investment and skill levels compared to the IT sector. Finally, in addition to bringing in foreign exchange and helping build IT skills in people, the sector also helps reduce spatial inequalities as more of these activities are being located in Tier 2 and 3 cities as Tier 1 cities become more expensive. The sector would benefit from government support and collaboration in a few critical areas, including more reliable Internet services; a focused and sustained promotion campaign (both country branding and sector branding); and high-profile networking events aimed at proactively addressing the main concerns of industry players in target markets. Demonstrable and long-run commitment by the government is essential to boost investor confidence. Addressing the main hurdles to doing business in Bangladesh would also support sector growth by establishing standard legal provisions such as intellectual property rights, confidentiality, data security, and so forth. (For details, see chapter 15 on ITES-BPO and World Bank 2012).

2.48 Some reforms could also be carried out at the regional level. The regulatory heterogeneity in South Asia increases the difficulties of services integration in the region. A cross-country comparison indicates that each country maintains different regulatory measures that affect trade in services (xx 2012). In the case of air transport services of passengers, Bangladesh does not maintain any foreign ownership restriction; Pakistan and Sri Lanka maintain a 49 percent limit to foreign ownership, as does India, which

¹⁶ According to some estimates, every job created in the ITES-BPO sector creates 3–4 jobs in supporting sectors.

opened its market in 2012. In India, foreign ownership limitations in telecommunications depend on the modality of entry for both fixed-line and mobile telecommunications, and in Nepal there is an 80 percent limit on foreign ownership in both services. Pakistan and Sri Lanka maintain no foreign ownership limitations. In this context, Kox and Lejour (2005) find that variations in the transparency of regulations across countries affect bilateral service exports negatively. Yet, although the policies may differ among countries, the range of restrictions applied is limited, which facilitates reaching agreements on a common regime for the region. Chapter 3 discusses areas for regional policy reforms.

8 Conclusions

2.49 In pursuit of multiple objectives, Bangladesh has over the years created a complex trade regime, including both tariffs and nontariff measures. Like in many other countries, the consumer or exporter has not been the focus of government's policy intentions. However, much can be done to make trade policy more efficient as part of "first-generation" reforms, to be followed by more intensive reforms. Bangladesh can learn from the experience of "successful globalizers" such as Singapore; Taiwan, China; or the Republic of Korea, all of which followed consistent long-term strategies centered around export competitiveness. In this context, balancing the interests of producers, consumers, and exporters would be useful. Extending this logic, reducing cross-sector distortions in the export incentive structure would help in Bangladesh's continued quest for export diversification.

2.50 A more harmonized and simpler import tax regime would reduce distortions and ensure a level playing field among and within sectors and firms, which would favor the development of new export sectors and small and medium enterprises. This reform is possible without hurting the overall objective of revenue growth. There are several ways Bangladesh could deal with para-tariffs, all of which aim to phase in a more trade-neutral tariff structure: (i) eliminate para-tariffs and put everything in the import tariff to boost transparency; (ii) lower para-tariff rates; and (iii) ensure that para-tariffs apply both to domestic production and imports, which would help reduce their distortionary impact.

2.51 Successful implementation of the NBR's reform agenda will be critical to help the government shift trade policy from a focus on revenue generation to a long-term national competitiveness strategy. The objectives of the reform are to (i) continue to reduce the budget's dependence on border tax; (ii) close tax loopholes and make the fiscal playing field less uneven across sectors and types of actors; (iii) Review existing fiscal incentives and tax holidays with the objective of adopting more coherent, transparent, predictable, and time-bound (incorporating sunset clauses) policies; (iv) extend access to Bonded Warehouse facilities to reputable companies using World Customs Organization Authorized Economic Operators (AEO) guidelines and criteria; and (v) generate the resources needed for the massive infrastructure investment effort that awaits national authorities if growth is to continue at the same pace

2.52 Greater openness in some services would help boost the productivity of the manufacturing sector and expand trade in services. A priority action would require the formulation and adoption a strategy for services trade and establishing a database on trade in services. Priority sectors could include air freight services and certain elements of the telecoms sector.

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Annex A. Survey Data and Computations for ERP Analysis

2.53 An industry survey of about 118 enterprises was conducted during May–July 2012, led by the Policy Research Institute (PRI) of Bangladesh. However, the production, sales, and tariff data are for FY 2010/11, so the analysis refers to the trade policy regime prevalent in FY 2010/11. Anticipating some unusable data, the goal of the exercise was to compute ERP estimates for at least 100 firms and this expectation was fulfilled.

2.54 Two sets of questionnaires were distributed to the firms surveyed: (i) a set of qualitative questions to elicit how enterprise management perceived and coped with the existing policy regime, and how that impacted profitability and incentives for production, investment, and exports; and (ii) a second set of quantitative questionnaires sought data on output, employment, sales, inputs, and costs, including taxes paid or benefits received.

2.55 The objective of the exercise was to ensure that reliable data was retrieved from some 100 enterprises covering the 10 selected subsectors¹⁷ listed in table 2A.1. A key part of the study was to compare relative incentives between exports and domestic sales. Therefore, the survey ensured that the majority of the firms selected were engaged in both domestic as well as export production.

Table 2A.1: List of Subsectors for Enterprise Survey

- 1. Agro-based industries
- 2. Ceramics products
- 3. Footwear and leather products
- 4. Plastics
- 5. Pharmaceuticals
- 6. Electronics/electrical products
- 7. Bicycle
- 8. Light engineering
- 9. Jute textiles
- 10. Garments and packaging

Product ERPs were computed using NPR and tax data from the FY 2010/11 OTS (Operative 2.56 Tariff Schedules, available at HS-8 digit codes) with the collected firm-level survey data. In addition, use was made of the Automated System for Customs Data (ASYCUDA) database. Disaggregated import and export transactions for FY 2010/11 provided cif and fob values for imported and exported commodities. In particular, the survey data included, among others, (i) the domestic price, total value, and volume of tradable outputs produced by the firm; (ii) the domestic price, total value, and volume of purchased tradable inputs used in the production of outputs; and (iii) the total ex ante protection, tariffs and paratariffs (SD, RD), and trade-neutral levies such as VAT, on all tradable inputs and outputs. In computing ERP, to the extent that VAT and SD were trade neutral, these two taxes had to be netted out prior to computing value added at domestic and world prices. Finally, a caveat is that nontraded inputs such as transport services, repair services, gas, electricity, water and other utilities, and so forth are excluded in order to keep the survey within manageable limits. However, note that the main indirect tradable inputs, such as fuel oil, repair materials, and so forth used for producing the nontraded inputs, have NPRs largely around 12 percent or lower; and import-substituting outputs mostly have NPRs of 50 percent or higher. As such, the current ERP estimates may, if anything, have a slight downward bias.

¹⁷ Of the 11 subsectors selected for the survey, no response was received from enterprises identified in the chemical/batteries subsector.

1. Methodological Issues

2.57 The ERP measures the relative difference in value added at domestic prices (protective effect on output net of protective effect on inputs) over value added measured in world prices. The formula can be simply expressed as in equation (2A.1):

ERP = (VADP/VAWP) - 1

(2A.1)

where VADP represents value added at domestic prices $[QPq^*(1+NPRq) - \sum AiPi^*(1+NPRi)]$, and VAWP represents value added at world prices $[QPq^* - \sum AiPi^*]$.

2.58 Thus domestic price of output and inputs may be related by the equations:

and $Pq = Pq^*(1+NPRq)$, which yields $Pq^* = Pq/(1+NPRq)$ $Pi = Pi^*(1+NPRi)$, which yields $Pi^* = Pi/(1+NPRi)$.

2.59 It is conventional to use the results produced by the formula in equation 2A.1 and express them in percentages.

1.1. Deriving Value Added at World prices (VAWP)

2.60 An industry survey typically yields data in terms of what is observable—that is, domestic prices. So the firm and product-level survey data at first yields value added at domestic prices (VADP). The challenge lies in computing VAWP, which requires data on world prices of inputs and outputs.

2.61 In the absence of observed world prices, the traditional approach (found in other studies on ERP) is to derive world prices through tariff deflation, that is, by deflating observable domestic prices of outputs (Pq) or inputs (Pi) by the nominal rates of protection (NPR). Thus VAWP (sales revenue at world prices minus input costs at world prices) could be derived through this deflation method. PRI's annual databases titled Operative Tariff Schedules (OTS) were used as the source for NPR data. It is relevant to note that the survey responses produced data on multiple products with quantum of inputs (Ai) used in each output separately (in most cases) so that input-output coefficients were available from the data.¹⁸ Thus, for the purpose of the present computation and analysis of firm-level product ERP, the required background data is available from the OTS combined with survey data.

2.62 The second approach is to use observed world prices from import and export data. Given that the Bangladesh customs administration has adopted the ASYCUDA system for nearly two decades, the ASYCUDA database yields information on cif or fob prices of imports and exports, that is, world prices of traded commodities. For the present study, the ASYCUDA database was the main source of information for obtaining world prices of products under study. However, there is an additional challenge of picking a representative price from many import or export transactions of the same commodity with a range of prices. The approach followed here was that of picking the cif price from the database that was the closest approximation to the tariff-deflated notional world price (used in most ERP studies).¹⁹ In the circumstances, results based on this approach should be interpreted with caution.

¹⁸ In those few instances where inputs were not specified for multiple outputs, we applied the method of assigning inputs on the basis of output share.

¹⁹ Ideally, taking an average of the range of prices would have been the best option. However, for 165 output products and at least 500 inputs covered by the survey, this exercise would have taken the kind of time and resources not available to this study.

2.63 Thus the two approaches represent an analytical framework for effective protection analysis, whose data demands are within the scope of this study.

1.2. Addressing Tariff Redundancy

2.64 Computation of ERPs based on estimated protective effect of nominal tariffs on outputs and inputs should take into consideration the real possibility of the existence of tariff redundancy, that is, a situation where the observed price of an import substitute product is below the price calculated by escalating the world price by the nominal rate of protection. Provided there is reliable data on cif prices, it is possible to gauge the magnitude of tariff redundancy by comparing observed domestic and world prices. This has been done for a sample of 34 products from the survey (annex B), revealing that tariff redundancy is indeed widely prevalent, and much higher for those products subject to very high tariffs, such as ceramic tableware, agro-based products like biscuits, modified rice products (chira, muri), plastic products like chairs and hangers, and so on. But pharmaceutical drugs and electronic products like solar home lights, which have the minimum tariffs on both outputs and inputs, show no tariff redundancy

2.65 In the Bangladesh context, tariff redundancy can occur due to several reasons:

- If the domestic product is an imperfect substitute of the comparable import, in terms of quality or any other aspect, the domestic price may be lower than the price of the comparable imports that fully reflects the protective tariff.
- Under-invoicing, to evade import taxes, is widespread, particularly in cases where the tariff is high, because the incentive for evasion is higher with higher tariffs, and this then reflected in a lower domestic price.
- Smuggling across the Bangladesh-India border is also rampant and an option for evading import taxes.
- In the case of jute textiles (such as yarn, hessian, and sacking), the protective tariff is notional as Bangladesh is a major exporter of jute goods and little or no import takes place.
- However, in the case of pharmaceutical products, the opposite is true. Tariffs on locally produced generic equivalent of brand-name drugs is zero or 5 percent, but a highly restrictive drugs policy prohibits imports of all drugs produced domestically. This policy has yielded good results in that domestic production now meets practically all domestic demand for these drugs (95 percent of local demand according to a World Bank (2008) study). The effective protective tariff in this case could be much higher than the actual tariff, though restrained by some control on prices imposed by the Drug Administration.

2.66 The implication of the existence of tariff redundancy is that when world price of a product is derived through tariff deflation, the derived world price will be less than the actual (since the tariff is higher than is consistent with domestic prices). Since output tariffs in Bangladesh are significantly higher than average input tariffs, derived VAWP (which uses the world price) will be lower (sometimes even negative), and estimated ERPs higher (negative if VAWP turns negative), than actual. So it is important to keep the issue of tariff redundancy in mind when computing ERPs using tariff deflation, and interpreting those results. To cite some examples, the 200 percent protective tariff on biscuits is redundant by at least 100 percent (as no importer actually pays the 200 percent tariff). The 49.5 percent tariff on jute textiles is also redundant, by and large. An assumption of 0–15 percent protective tariff yields plausible ERP results for jute yarn, hessian, and jute sacks—traditional exports of Bangladesh for decades.

1.3. **Protection Level in Exports**

2.67 While the preceding approach is appropriate for computing ERP for domestic sales, measuring incentives in export production arising from the tariff regime requires a slightly different approach, for the following reasons. First, there is zero protection on the output destined for exports, where prices are actually fixed in the international markets. Second, imported inputs used in the production of exports are

eligible for duty drawback, or are exempt from duty and other import taxes altogether through SBW arrangements. Third, an exporting firm may receive cash assistance (of 10–20 percent of export volume) if it uses neither a duty drawback nor the SBW facility.

2.68 Under the assumption of 100 percent duty drawback, ERPs are, by definition, zero, because inputs become tariff free, while outputs simultaneously receive zero protection in the international market. However, it is a known fact—also confirmed by various studies—that there are transaction costs (informal payments and delays in receipts) associated with reimbursement of duty drawback, resulting in, at best, receipt of 75 percent of the actual duties incurred on imported inputs. In the circumstances, ERPs are typically negative since output prices are determined internationally and therefore receive no protection. Some exports are eligible for a cash subsidy of 10 percent on export volume paid in lieu of duty drawback, which might compensate for duties paid on imported inputs.

2.69 Thus, typically, ERP for exports is expected to approach zero, be modestly positive arising from cash incentives, or negative if the reimbursement of duty drawback does not fully compensate for the tariff-inclusive costs of procuring imported inputs or domestic inputs propped up by protective tariffs.



Figure 2A.1: Financial Services Restrictiveness

Figure 2A.3: Retail Services Restrictiveness



Figure 2A.2: Telecommunications Services Restrictiveness



Figure 2A.4: Transport Services Restrictiveness



Figure 2A.5: Professional Services Restrictiveness



Enter- prise ID	Subsector	Product	Protective tariff (%)	cif Price	Survey price	Price ratio (survey/cif)	Tariff redundancy (%)
004	Agro-based Industries	Chanachur	56.00	79.01	110.43	39.77	16.23
004	Agro-based Industries	Mustard Oil	30.00	170.14	189.57	11.42	18.58
65	Agro-based Industries	Muri	56.00	43.34	47.83	10.35	45.65
065	Agro-based Industries	Chira	108.00	35.50	38.26	7.78	100.22
094	Agro-based Industries	Biscuit	199.00	71.01	123	73.22	125.78
090	Agro-based Industries	Frooto Mango	41.82	297	328.06	10.46	31.36
117	Bicycle	Mountain Bicycle	56.00	3,197	4521.7	41.44	14.56
119	Bicycle	Standard Bike 28"	56.00	2,984	4347.8	45.70	10.30
120	Bicycle	Motor Bike 26"	56.00	2,984	3913	31.13	24.87
086	Bicycle	Sun Share (Bicycle)	56.00	2,368.07	3043.4	28.52	27.48
005	Ceramic	Dinner Plate	88.50	42.65	56.52	32.52	55.98
057	Ceramic	Ceramic Table ware	88.50	28.98	46.96	62.03	26.47
021	Embroidery	3 Piece Embroidery	30.00	320.21	320.21	0	30.00
021	Embroidery	Child Garments Embroidery	30.00	1.76	2.17	23.52	6.48
033	Electronics/ Electrical Products	Solar Home Light	30.00	258.28	334.78	29.62	0.38
033	Electronics/ Electrical Products	Solar Charge Controller	3.00	507.67	507.16	-0.10046	3.10
040	Footwear	Gents Leather Shoes	88.50	1,210.00	1,956.5	61.70	26.80
017	Garments	Shirt	56.00	355.02	531.06	49.58	6.42
017	Garments	Panjabi	56.00	585.08	885.38	51.33	4.67
016	Jute Textiles	Jute goods	49.50	81,880	101839.4	24.38	25.12
012	Jute Textiles	Yarn	49.50	79,540	92000	15.67	33.83

Annex B. Analysis of Tariff Redundancy

Enter- prise ID	Subsector	Product	Protective tariff (%)	cif Price	Survey price	Price ratio (survey/cif)	Tariff redundancy (%)
050	Jute Textiles	Hessian	49.50	87,998	101,000	14.78	34.72
050	Jute Textiles	Sacking	49.50	63,004.20	72000	14.28	35.22
111	Light Engineering	Carbon Rod	56.00	0.44	0.51	16.60	39.40
020	Plastics Products	Plastic Chair	56.00	397.34	410.00	3.19	52.81
020	Plastics Products	Plastic Table	56.00	942.95	1,260.87	33.72	22.28
020	Plastics Products	Plastic Wardrobe	56.00	1,026.50	1217.39	18.60	37.40
037	Plastics Products	100 ml Bottle	108.00	0.60	0.88	46.67	61.33
037	Plastics Products	Ponds Jar	60.00	1.08	1.42	31.08	28.92
011	Pharmaceuticals	PPI-20	5.00	3.29	3.52	6.99	-1.99
011	Pharmaceuticals	Tenoloc-50	5.00	0.72	0.74	4.03	0.97
011	Pharmaceuticals	Ecosprin	5.00	0.42	0.47	11.11	-6.11
105	Pharmaceuticals	Acitrin	13.04	34.26	40.87	19.29	-6.25
105	Pharmaceuticals	Tenorin	5.00	40.45	46	13.72	-8.72

Source: PRI 2012; ASYCUDA Database for cif price.

Bangladesh Market Access: From Preferences to Global Integration

3.1 Bangladesh's export growth has largely been driven by preferential schemes extended by the European Union (EU), and to some extent by similar agreements with the United States and other advanced economies. It also benefitted from large preferential margins compared to China due to a number of antidumping duties and market restrictions, mostly imposed by the EU against Chinese exports. Bangladesh is also eligible for the duty-free & quota-free (DFQF) market access for LDCs agreed to in the WTO Ministerial Conference held in Hong Kong in 2005, and to DFQF access offered by India in November 2011 to all South Asian LDCs including Bangladesh.

3.2 However, changes in the global economy will require Bangladesh to find a more sustainable path for export growth. Industrial country growth has been slow to recover from the dual financial and debt crisis that began in 2007, including in Bangladesh's key trading partners, the United States and EU. Emerging economies, led by China and India, have recovered much faster, driven by both a buoyant domestic demand and international trade. However, Bangladesh's share of these traditional markets will likely be challenged by countries such as Vietnam and Cambodia, which receive equal or better trade access to the United States. Any reduction in MFN duties by US and EU under future World Trade Organization (WTO) negotiations likely to reduce Bangladesh's preferences and undermine its future competitiveness in developed country markets.

3.3 Bangladesh could better exploit regional production-sharing potential to take advantage of fundamental changes in the global economy, including global value chains and demographic shifts. Many goods and services are no longer designed, produced, and sold within a single country. Rather, these functions are spread across multiple countries within regional and global supply chains. Factors that have spurred the development of these chains include falling trade costs, technological change, and institutional development in areas such as property rights. As countries have become more integrated into these chains, they have become more specialized in specific tasks based on comparative advantage. Moreover, the global financial crisis has led to large demographic shifts in East Asia and the Pacific (Ng and Yeats 2003), especially in China. This will likely create new alignments within existing global production and trade networks. For example, China is rapidly losing the advantage of low labor costs due to slow population growth and rising wage pressures. Capturing just one percent of China's manufacturing export markets would almost double Bangladesh's manufactured exports.

3.4 Global developments also give Bangladesh an opportunity to improve regional and South-South trade. There is growing consensus among economists about the importance of the "new markets margin," through which developing countries can become more integrated in the world trading system. An extension of the welfare dimension suggests that a certain level of product and market diversification is necessary to insulate against demand shocks and obtain a minimally volatile export portfolio (Sheppard 2010). India is leading the way in South Asia with its "Look East" policy to deepen trade and investment integration with East Asia. In Bangladesh, market shares of some emerging markets such as China, India, and Turkey have increased.

3.5 This chapter provides an overview of Bangladesh's current access conditions in its primary export markets, as well as prospects and constraints of expanding and diversifying its market access. We draw

lessons from the successes and challenges of the India-Sri Lanka free trade agreement (FTA) to inform Bangladesh's integration in global production chains. Finally, we discuss the role of the Export Promotion Bureau (EPB) in achieving the government's export promotion objectives.

1 Preferential Access for Bangladesh in Advanced Economies

1.1 EU Market Access

3.6 Bangladesh was accorded the most generous market access conditions, relative to non-LDCs, to the EU market under the Everything But Arms (EBA) initiative (box 3.1) Overall, EBA countries have significant preferences (3 percent or more) for 2 out of 21 sectors (live animals and vegetable products) compared to General System of Preferences (GSP) or GSP+ countries. For many products, particularly for industrial products, the scheme has provided fewer benefits to least-developed countries (LDCs) than to more-developed GSP or GSP+ competitors. In 2008 GSP beneficiaries accounted for 81 percent of preferential imports, GSP+ countries for 9 percent, and LDCs countries for 10 percent. The top beneficiaries of EU preference regimes are five large exporters (China, India, Thailand, Brazil, and the Russian Federation); they accounted for more than 67 percent of all GSP-covered imports. The GSP imports of these beneficiaries are significantly higher than their total EU imports (non-GSP).

Box 3.1: EU Preferential Regimes

The EU has long maintained both nonreciprocal generalized preference schemes (GSP) and reciprocal trade arrangements (principally FTAs) to some 176 countries and territories. The GSP schemes have evolved over the past two decades into three principle regimes:

(i) A standard GSP that confers preferences to all developing countries for qualifying products, based on graduation criteria

(ii) GSP+ regimes with greater preferences, which are offered to 49 vulnerable developing countries as an incentive for them to ratify and effectively implement a set of key international conventions

(iii) An even more generous "Everything But Arms" (EBA) regime, which confers duty- and quota-free access to LDCs

Introduced in 2001, EBA removes the uncertainties of earlier GSP schemes. Nearly 25 percent of tariff lines in EU have been duty free, irrespective of preferences. For GSP and GSP+ beneficiaries, 91 percent of tariffs lines have been either preferential or duty free, and virtually 100 percent for EBA beneficiaries. Under such favorable market access, rules of origin (RoO) and relative preference margins over other beneficiaries became key determinants of Bangladesh's exports to the EU.

3.7 Bangladesh's export performance has thrived on account of strong apparel growth, despite the seemingly strict rules of origin (RoO). The EU maintained multiple product- and sector-specific RoO, and options for regional cumulation were deemed too complex or too restrictive for a small and undiversified manufacturing base as in Bangladesh (Bhattacharya Rahman, and Raihan 2004). Nevertheless, Bangladesh's exports to the EU increased at 13 percent per annum between 2000 and 2011 (largely by growth in apparel), which outpaced the EU's average import growth of 6 percent by 200 percent. Relative to its main competitors in the ready-made garment (RMG) sector, Bangladesh's performance exceeded expectations, given the country's size. Bangladesh expanded its market share in the EU from 3.2 percent in 2000 to 8.2 percent in 2011 (table 3.1). In comparison, China's market share in EU RMG imports in 2011 was around 30 percent, though China is 30 times larger than Bangladesh in terms of GDP.

3.8 Bangladesh has steadily increased its share of exports to the EU under preferential regimes since the inception of EBA, from around 51 percent in 2000 to around 83 percent in 2010 (table 3.2). Conversely,

exports not meeting RoO declined from 90 percent in 2000 to 20 percent in 2010. The favorable trend is largely attributed to knitted garments: Bangladesh's preference utilization in knitted and crocheted garments exceeds 95 percent, about double the utilization for woven garments (tables 3.3 and 3.4). The RoO quite likely propagated backward linkages in knitted garments, especially in spinning of yarn.

					Apparel			Marke	et share	
					export	s (US\$	Appare	el market	Non-	apparel
		Expo	ort growth 2	2000–11	bill	ion)	sh	are	mark	et share
		Total	Apparel	Nonappa	2000	2011	2000	2011	2000	2011
Country	Regime			rel						
Bangladesh	EBA	13.4	14.0	9.5	2.5	10.6	3.5	8.2	0.02	0.03
Cambodia	EBA	17.6	16.6	20.6	0.3	1.5	0.4	1.1	0	0.01
China	MFN	15.7	16.1	15.6	7.7	39.9	10.8	30.7	2.7	7.01
Egypt, Arab	IF	12.1	7.5	12.4	0.3	0.6	0.4	0.5	0.12	0.24
Rep.										
India	GSP	13.1	10.5	13.5	2.1	6.1	2.9	4.7	0.43	0.92
Indonesia	MFN	4.4	0.3	5.1	1.8	1.9	2.6	1.5	0.4	0.36
Jordan	IF	6.6	-1.1	7.6	0.0	0.02	0.0	0.0	0.00	0.01
Lao PDR	EBA	2.9	0.2	11.7	0.1	0.1	0.2	0.1	0.00	0.00
Pakistan	MFN	7.6	10.2	6.7	0.6	1.7	0.8	1.3	0.08	0.09
Sri Lanka	GSP	7.5	8.4	6.2	0.8	2.01	1.2	1.6	0.03	0.03
Vietnam	MFN	12.6	9.8	13.2	0.8	2.2	1.1	1.7	0.15	0.31

 Table 3.1: Export Performance of Bangladesh and Its Competitors in the EU, 2000–11

Source: Based on United Nations Commodity Trade Statistics Database (UN Comtrade) via World Integrated Trade Solution (WITS).

Note: Non-apparel exports represents all other exports except apparel. Countries subject to EBA regime are in bold. EBA: Everything But Arms; GSP: General System of Preferences; IF: Free Trade Agreement in force; MFN: Most Favored Nation.

Table 3.2: Bangladesh's	Total Exports under	r EBA Regime:	2000, 2005, and 2010
	r r r r r r r r r r		

Notation	Declarant/period	2000	2005	2010
A1	Not EBA eligible, only MFN=0	50.9	62.7	79.1
A2	Not EBA eligible, only MFN>0	0.0	0.0	0.0
A3	Not EBA eligible, entered unknown status	0.0	0.0	0.0
A4	EBA eligible, but entered MFN=0	0.8	0.8	1.0
A5	EBA eligible, but entered MFN>0; did not meet RoO	1,356.8	1,394.6	1,459.0
A6	EBA eligible, entered pref=0	1,406.4	3,313.3	7,088.8
A7	EBA eligible, entered pref>0 (specific duties)	0.0	0.0	0.0
A8	EBA eligible, entered unknown status	11.0	324.0	59.4
	EBA utilization (A6+A7+A4)/(A4+A5+A6+A7)	51%	70%	83%
	Duty free (pref + MFN) as share of total	52%	66%	83%

Source: Calculations based on EUROSTAT.

Notation	Declarant/period	2000	2005	2010
B1	Not EBA eligible, only MFN=0	0.0	0.0	0.0
B2	Not EBA eligible, only MFN>0	0.0	0.0	0.0
B3	Not EBA eligible, entered unknown status	0.0	0.0	0.0
B4	EBA eligible, but entered MFN=0	0.0	0.0	0.0
B5	EBA eligible, but entered MFN>0; did not meet RoO	367.3	252.0	206.4
B6	EBA eligible, entered pref=0	858.0	2,326.5	5,093.7
B7	EBA eligible, entered pref>0 (specific duties)	0.0	0.0	0.0
B8	EBA eligible, entered unknown status	6.1	157.7	37.1
	EBA utilization (B6+B7+B4)/(B4+B5+B6+B7)	70%	90%	96%
	Duty free (pref + MFN)	70%	85%	95%

Table 3.3: Bangladesh's Knitted and Crocheted Apparel Exports under EBA Regime: 2000, 2005, and 2010

Source: Calculations based on EUROSTAT.

Table 3.4: Bangladesh's Woven	Garments Exports under	EBA Regime: 2000	. 2005. and 2010
)

Notation	Declarant/Period	2000	2005	2010
C1	Not EBA eligible, only MFN=0	0.0	0.0	0.0
C2	Not EBA eligible, only MFN>0	0.0	0.0	0.0
C3	Not EBA eligible, entered unknown status	0.0	0.0	0.0
C4	EBA eligible, but entered MFN=0	0.0	0.0	0.0
C5	EBA eligible, but entered MFN>0; did not meet RoO	957.1	1,104.9	1,180.5
C6	EBA eligible, entered pref=0	164.1	466.6	1,080.4
C7	EBA eligible, entered pref>0 (specific duties)	0.0	0.0	0.0
C8	EBA eligible, entered unknown status	4.1	85.0	17.0
	EBA utilization (C6+C7+C4)/(C4+C5+C6+C7)	15%	30%	48%
	Duty free (pref + MFN)	15%	28%	47%

Source: Calculations based on EUROSTAT.

3.9 Bangladesh's margin of preference over non-GSP countries suffered little erosion between 2000 and 2008 (table 3.5). Margin of preference erosion from 2002 to 2008 does not appear to be significant for EBA beneficiaries, except in live animals (3.3 percent). Overall, EBA beneficiaries enjoyed at least a 4 percent margin of preferences compared to most favored nation (MFN) countries in 10 out of 21 Harmonised Commodity System (HS) sections, with a peak of 17 percent (table 3.4).⁴¹ Bangladesh's preferential margin in apparel (HS Section 11b) is the second highest of EBA countries, and is 11.2 percent greater than MFN beneficiaries. Bangladesh shares the same margin of benefit with other GSP+ members, none of whom are major RMG producers or exporters.

⁴¹ The 4 percent threshold can be a significant advantage, particularly in manufacturing sectors. Note, however, that it may not be precise, given intersector variation, and the impact of similar preferences can be very different depending on the product concerned. It is, nevertheless, considered as sufficiently indicative. The justification is highlighted in a recent study (EU 2011: 75–76), which finds that preferences are being used significantly even though preference margins are very low.

HS section	Preference margin over MFN in 2008 (%)			Preference margin over MFNChange in preferencesonin 2008 (%)2002–08			rences	Margin of preferences between regimes (%)			
Section	GSP	GSP+	EBA	GSP	GSP+	EBA	GSP+/GSP	EBA/GSP	EBA/GSP+		
Section 1	2.6	6.7	17.3	1.1	0.6	-3.3	4.2	14.8	10.6		
Section 2	2	5	9.4	-0.3	0	-2.8	3	7.4	4.4		
Section 3	3.3	6.5	8.6	0.4	0.7	1.4	3.2	5.3	2.1		
Section 4	5.6	14.8	17	2	0.9	1.2	9.3	11.5	2.2		
Section 5	0.7	0.7	0.7	0	0	0	0	0.1	0.1		
Section 6	4.2	4.9	5.1	0.2	0.2	0.2	0.7	0.9	0.3		
Section 7	4.4	5.5	5.5	-0.2	-0.4	-0.4	1.1	1.1	0		
Section 8	2.2	2.8	3	0.1	0.1	0.1	0.7	0.9	0.2		
Section 9	1.8	2.4	2.4	-0.1	-0.4	-0.4	0.6	0.6	0		
Section 10	0	0	0	-1.5	-1.5	-1.5	0	0	0		
Section 11a	1.3	6.2	6.2	-0.1	-0.5	-0.5	5	5	0		
Section 11b	2.2	11.2	11.2	-0.1	-0.3	-0.3	9	9	0		
Section 12	3.6	7.6	7.6	-0.2	-0.7	-0.7	4	4	0		
Section 13	2.6	4	4	0	0	0	1.3	1.3	0		
Section 14	0.7	0.7	0.7	-0.1	-0.1	-0.1	0	0	0		
Section 15	1.5	1.9	2	-0.4	-0.4	-0.4	0.4	0.5	0.1		
Section 16	2	2.3	2.3	-0.1	-0.1	-0.1	0.3	0.3	0		
Section 17	2.9	4.6	4.6	-0.1	-0.4	-0.4	1.7	1.7	0		
Section 18	2.1	2.3	2.3	-0.1	-0.2	-0.2	0.2	0.2	0		
Section 19	0	0	0	0	0	0	0	0	0		
Section 20	2.4	2.5	2.5	-0.1	-0.1	-0.1	0.1	0.1	0		
Section 21	0	0	0	0	0	0	0	0	0		

Table 3.5: Preference Margins under EU GSPs, 2002–08

Source: EU Commission 2011.

Note: HS = Harmomised Commodity System.

3.10 The EU has revised its GSP scheme to make it more equitable and in line with its external economic policy on developing and vulnerable economies (EC 2011). The new scheme will be implemented in January 2014, leaving time for countries to adjust, and includes the following features. First, it aims to concentrate GSP preferences on fewer countries by withdrawing benefits to high- or upper-middle-income countries that already have GSP-level preferential access to the EU. Preferences will also be withdrawn from overseas countries and territories that have an alternative arrangement for access to developed markets. Second, the new regime rewards respect for core human and labor rights, environmental protection, and good governance by increasing importers' access to the GSP+ scheme. Countries will have to reapply for GSP+ status after complying with about 27 requirements. Third, the new GSP scheme strengthens trade concessions for LDCs through the EBA scheme, which will reduce competitive pressure on LDCs and make their preferences more effective. Finally, revisions will increase the predictability, transparency, and stability of the GSP scheme by making it open-ended, rather than subject to review every three years as is current practice.

3.11 Bangladesh will likely be negatively impacted by the new GSP scheme. A SMART simulation of the adopted scheme indicates that the benefits will likely be concentrated on GSP+ beneficiaries, rather than LDCs (EC 2011). Estimates show that Bangladesh could suffer a welfare loss of about 0.31 percent as a consequence of the potential entry of Pakistan into GSP+, which would depress textile exports of Bangladesh. Under the current EU GSP, specific sectors or products are graduated out of the GSP or the GSP+ if they total 15 percent of EU imports over three consecutive years (the trigger is 12.5 percent for textiles and clothing). However, the sectors which will actually be graduated are not known at this stage. They will depend on the latest available import figures prior to the entering into force of the new

regulation. Graduation of other countries' exports, such as Indian textiles, could lessen the negative impacts on Bangladesh.

3.12 Meanwhile, Bangladesh's textile and clothing industry will benefit from more favorable RoO. Anecdotal evidence suggests that the EU's replacement of the "two-stage" processing requirement with "one-stage" processing, effective January 2011, has resulted in a surge in Bangladesh's apparel exports to EU. This new ruling allows imported fabrics in apparel exports, which makes it possible to use existing capacity in the knitted garment sector. More important, preferred exports of woven garments will likely expand.

3.13 Bangladesh should be able to use the relaxed fisheries rules to enhance exports in the fishery sector. For fish caught outside territorial waters, a prior requirement that 50 percent of the crew on the fish-catching vessel be EU or beneficiary country citizens has been removed. In addition, the value "tolerance" determination for fishery products (HS Chapter 16) has been raised from 10 to 15 percent. This could enable diversification toward other fish varieties using Bangladesh's comparative advantages, (including a high water-to-land ratio, and an abundance of varieties such as Hilsa). In addition, a weight tolerance determination replaces value tolerance, although levels for both LDCs and non-LDCs remain fixed at 15 percent. However, a number of technical requirements and RoO will likely continue to restrict access to the EU market. For example, some product-specific RoO such as in fish and fish products, certain processed agriculture products, and a range of manufacturers remain too restrictive in accessing the EU market. In addition, restrictive cumulation may deter developing countries from fully exploiting their comparative advantage.

3.14 Beyond the EBA scheme, Bangladeshi exporters have often benefitted from EU restrictions on Chinese exports to the EU. This is true for garment exports in the context of the Multi Fibre Arrangement (MFA), which governed the world trade in textiles and garments from 1974 through 2004 through quotas on developing countries' exports to developed countries. However, the MFA imposed no restrictions or duties on imports from the poorest countries, such as Bangladesh, which widened the preferential margin and contributed to textile sector expansion in these economies. Similarly, the value-chain analyses conducted in the context of the diagnostic trade integration study (DTIS) found that the exports of a number of successful, nongarment firms benefitted from antidumping duties imposed against Chinese exports for bicycles, leather shoes, and ceramics. While EU MFN duties on shoes were between 3-17 percent, the EU imposed antidumping duties on Chinese shoes at 16.5 percent, and on Vietnamese shoes at 10 percent. The EU duties were inaugurated in 2006, were extended for 15 months in December 2009, and expired in 2011. European trade protection against Chinese bicycles dates to 1993, when the EU introduced a 30.6 percent antidumping duty on imports from China. The EU renewed that levy in 2000 before raising it to the current 48.5 percent in 2005. At the same time, the EU introduced antidumping duties as high as 34.5 percent on imports from Vietnam.

1.2 U.S. Market Access

3.15 The United States does not provide duty-free access for some key Bangladesh exports, and only a few goods qualify under the U.S. Generalized System of Preferences. The U.S. GSP program is rather straightforward. The program divides eligible countries into two groups based on their income levels: all developing countries, and a subset of the LDCs. However, product coverage is far more limited than the EU program and excludes most textiles and apparel. In 2010, the GSP provided preferential duty-free entry for about 3,400 products from 129 designated beneficiaries, and an additional 1,400 products from beneficiaries designated as LDCs. The program requires beneficiaries to adhere to certain criteria, among them protection of specified labor rights and intellectual property rights. In addition, the program specifies graduation of countries that exceed a per capita income level, and graduation of products that

exceed "competitive-need limits" (CNL), currently around US\$110 million per tariff line. If the country's imports in a given category exceed 50 percent of total U.S. imports, it may also lose the GSP eligibility.⁴² Although the latter is not a concern for Bangladesh, labor practices have been subject to scrutiny. Previously accepted worker rights-related petitions from Bangladesh (as well as Niger, the Philippines, Sri Lanka, and Uzbekistan) remained under review as part of the 2011 GSP Annual Review process (USTR 2011). A public hearing was held in January 2012 on Bangladesh's petition, but its status remains indeterminate.

3.16 Bangladesh's performance in the U.S. market has been remarkable compared to competitors, despite lack of substantial preferential access and distance from market (figure 3.1). In 2005, signatories of the North American Free Trade Agreement (NAFTA) and Dominican Republic–Central America Free Trade Agreement (CAFTA-DR) were the largest beneficiaries of U.S. trade preferences for textiles and apparel, together accounting for 30 percent of U.S. imports of these items. China, without preferences, has grown its U.S. market share of textiles and apparel more than threefold since 2004. Bangladesh's market share in these products, already a substantial 3.3 percent in 2005, increased to 7 percent in 2011, exceeding NAFTA, whose market share declined substantially over the same period.



Figure 3.1: U.S. Market Share of Bangladesh's Top 25 Apparel Exports, 2004–11 (percent)

Source: ???

Note: ATPA = Andean Trade Preferences Act; CAFTA-DR = Dominican Republic–Central America Free Trade Agreement; CBI = Caribbean Basin Initiative; NAFTA = North American Free Trade Agreement.

3.17 Bangladesh's exports to the United States have gradually increased outside of GSP preferences. GSP utilization has in fact sharply fallen over the recent years from a high of 51 percent in 2007 to 35 percent in 2011. This in part reflects a decline in U.S. preferences for all beneficiaries. Of 119 Bangladeshi products imported under preferences, the top 10 accounted for 80 percent of GSP benefits. This skewed GSP utilization, and the general increase in nonpreferred exports, indicate that the GSP has not helped Bangladeshi exports to the United States diversify away from the RMG sector.

⁴² However, there is a de minimis waiver. The president has the discretion to waive the CNL if total imports of the United States in that category from all countries (both GSP eligible and ineligible) do not exceed US\$16.5 million.

Exports	2006	2007	2008	2009	2010	2011
GSP-eligible exports entering the United States under GSP	21	23.9	22.2	23.3	27.9	25.6
GSP-eligible exports NOT entering the United States under GSP	23.9	22.5	28.8	24.3	37.9	47.4
Total GSP-eligible exports entering the United States	44.9	46.4	51.1	47.6	65.8	73.1
Total exports to the United States	3,270	3,433	3,748	3,700	4,293	4,876
GSP-eligible exports entering the United States under GSP (%)	46.8%	51.5%	43.5%	48.9%	42.4%	35.1%
U.S. GSP exports as share of total (%)	0.6%	0.8%	0.7%	1.1%	1.2%	n.a.

Source: Based on U.S. Department of Commerce and the U.S. International Trade Commission statistics.

3.18 Bangladesh's preference margins have been limited and do not benefit its major exports to the United States, such as sleeping bags and bone china. Large GSP beneficiaries such as Brazil, China, India, and Pakistan receive the same preferences as Bangladesh and other LDCs, and they benefit much more when margins are small. In addition, Bangladesh has not fully exploited products with larger preferential margins, such as the nonhousehold porcelain (25 percent MFN). One explanation for the lack of penetration in the U.S. market may be the industry's principle focus on the EU market. The private sector and supporting institutions, such as the Export Promotion Bureau, may lack the capacity to articulate strategies that align Bangladesh's competitive products with market opportunities.

Bangladesh's U.S. market prospects will likely to be further reduced by preferential regimes 3.19 granted to competitor countries, including free trade agreements (FTAs) for textiles and apparel such as CAFTA-DR, the Andean FTA, and the North American FTA. The United States has also extended unilateral preferences to a number of countries, including countries of sub-Saharan Africa through the African Growth and Opportunity Act (AGOA), Caribbean Basin Initiative CBI, and Haiti. Haiti has the most advantageous access to the United States, both in terms of product coverage and in terms of RoO, where the standard "yarn forward" rule has been substantially relaxed. For example, certain apparel (Chapter 61 of the United Nations (UN) harmonized Classification system) is permitted duty-free access under tariff rate quotas subject to ad valorem de minimis rules rather than yarn forward. Haiti and the CAFTA-DR countries also permitted to export a certain share of otherwise non-qualifying apparel on a duty-free basis.⁴³ Utilization rates under these preferential arrangements have been relatively high, with the exception of the Caribbean Basin (excluding Haiti) and Andean countries. NAFTA (primarily Mexico) has maintained high utilization, ranging from 89 percent in 2005 to 97 percent during the first half of 2012. The CAFTA-DR countries and Haiti have likewise attained high rates of utilization of their respective preference programs, reflecting their adaptation to strict U.S. RoO. NAFTA, CAFTA-DR, and Caribbean Basin Trade Promotion Act (CBTPA) countries have long benefitted from U.S. preferences. In particular, early outward processing rules encouraged the development of apparel industries specifically geared toward make-trim and cut-make-trim using almost exclusively U.S. fabrics.

⁴³ Under the Earned Import Allowance Program (EIAP), Haitian producers, for every two square meter equivalents (SME) of qualifying fabric purchased or manufactured for apparel production in Haiti, can earn one SME credit that allows duty-free treatment for imports of apparel manufactured in Haiti using nonqualifying fabric.

		GSP		Valu	ue (US\$ mil	llion)
Product	HS code	regime	MFN	2009	2010	2011
Sleeping bags	94043080	А	9%	0.2	3.3	4.0
Tobacco, partly or wholly stemmed/stripped	24012085	A+	US\$0.375 per kilogram	5.4	2.1	3.4
Plastic packing of goods	39239000	A*	3%	3.9	4.2	2.8
Bone china household table and kitchenware	69111025	А	6%	0.3	1.4	2.5
Tobacco, partly or wholly stemmed/stripped	24012083	A+	US\$0.375 per kilogram	2.7	4.1	1.9
Carpets and other textile floor coverings	69111037	А	8%	0.4	1.1	1.6
Porcelain or china, non- household	69111010	A+	25%	1.4	1.1	1.5
Golf equipment	95063900	А	4.9%	4.0	3.6	1.3
Tobacco roots	24021030	А		0.0	0.0	0.8
Carpets and other textile floor coverings	57029920	A*	2.70%	0.7	0.7	0.5
Made-up articles of textile materials (flags)	63079098	А	7%	0.7	1.0	0.4
Plastic apparel and clothing accessories	39262090	А	5%	0.1	0.4	0.4
Prepared foods of cereals	19041000	А	1.1%	0.2	0.2	0.4
Spectacles, goggles, and the like	90049000	А	2.5%	0.1	0.0	0.4
Baskets and bags of vegetable material	46021918	A	4.5%	0.1	0.1	0.4
Juice of any other single fruit	20098060	А	0.5 cents/liter	0.0	0.0	0.3
Plastic sacks and bags	39232100	A*	3%	0.2	0.2	0.2
Other plastic goods, of polymers of ethylene	19059090	A	4.5%	0.2	0.3	0.2
Bone china household table and kitchenware	69111015	А	8.0%	0.2	0.2	0.2
Hides and skins	41044150	A*	3.3%	0.1	0.1	0.2

Table 3.7: Margin of Preference of Bangladesh's Top 20 GSP-Eligible U.S. Exports

Source: USITC (http://www.ustr.gov/sites/default/files/ATT%20(D)%20-%20Bangladesh%20CY08.pdf) and World Bank calculations.

Note: A+ Eligibility only for LDCs. A* Articles that are GSP eligible, except for imports from specific countries that have lost GSP eligibility for that article.

3.20 Bangladesh will also continue to face pressure from countries that are guarding their already more favorable preferences. Bangladesh and a group of 14 developing and LDCs⁴⁴ are currently attempting to obtain GSP access in the U.S. apparel market, including duty-free status like that currently enjoyed by AGOA, NAFTA, and CBTPA beneficiaries. This effort has resulted in U.S. legislation supporting duty-

⁴⁴ Countries include Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, the Lao People's Democratic Republic, the Maldives, Nepal, Samoa, Sri Lanka, the Solomon Islands, East Timor, Tuvalu, Vanuatu, and the Republic of Yemen.

free access by Bangladesh and others. A Bill presented to the US Congress requesting market access equal to the above beneficiaries faces opposition from AGOA countries and other apparel exporters such as Pakistan that fear erosion of their preferences. There is also domestic pressure to protect preferences to existing beneficiary countries, especially those within the Latin American and Caribbean region.

3.21 Moreover, the rapid extension of preferences to such countries as Haiti signals the geopolitical realities that are likely to impact decision-making in the United States. Haiti, despite its low absolute export values, doubled its preferred exports between 2005 and 2011, and U.S. bilateral support is proactively strengthening Haiti's export capacity. Even if efforts by Bangladesh and the LDCs to obtain duty- and quota-free access under GSP are successful, such preferences would likely come with rules similar to existing yarn forward RoO applied to other U.S. trade regimes. The yarn forward rules give U.S. regional partners a distinct advantage, particularly in light of transportation costs that may otherwise make CMT operations using U.S. fabric in more distant locations, such as Bangladesh, less cost competitive.

Program	Description	Eligible exports and rules of origin	Beneficiaries
Caribbean Basin	A trade preference program enacted in	Unlimited duty-free treatment for apparel manufactured in CBTPA	Antigua and Barbuda
Trade Promotion	October 2000. It provides duty-free	beneficiary countries, if it is wholly assembled, knit, or knit-to-shape	Aruba
Act (CBTPA)	treatment for apparel wholly assembled,	in CBTPA beneficiary countries, using:	Bahamas
	knit, or knit-to-shape in beneficiary	• U.S. yarn and fabric, cut in United States and assembled in	Barbados
	countries in the Caribbean, as long as the	CBTPA beneficiary countries	Belize
	apparel uses U.S. fabrics and U.S. yarns,	• U.S. yarn and fabric, cut in United States, further processed in	British Virgin Islands
	with some exceptions for knit products that	CBTPA beneficiary countries	Dominica
	are under a quota system	• U.S. yarn, fabric, and thread, cut in CBTPA beneficiary countries	Grenada
		 Brassieres cut and sewn in United States and/or CBTPA 	Guyana
		beneficiary countries	Haiti
		Certain knit apparel is subject to annual quotas or tariff rate quotas	Jamaica
		(TRO) The two TRO programs are as follows:	Montserrat
		 Knit apparel articles (excluding socks and nonunderwear T-shirts) 	Netherlands Antilles
		made of U.S. varn. CBTPA knit fabric, or knit-to-shape	Panama
		components that are cut and sewn in CBTPA beneficiary countries	St. Kitts and Nevis
		• Nonunderwear T-shirts of U.S. varn and CBTPA fabric that are cut	St. Lucia
		and sewn in CBTPA beneficiary countries	St. Vincent and the
			Grenadines
			Trinidad and Tobago
Hemispheric	Extends additional preferences above and	Allows duty-free treatment for certain apparel wholly assembled, knit,	Haiti
Opportunity for	beyond CBTPA	or knit-to-shape in Haiti, using yarns and fabrics from any country.	
Partnership		This is in contrast to CBTPA, which requires U.S. yarns and fabrics in	
(HOPE II)		order to qualify for duty-free treatment.	
		HOPE created two preference programs: the Value-Added tariff rate	
		quota (TRQ) and the Woven and Knit Apparel Apparel TRQ, each of	
		which limit qualifying imports to certain annual quotas. The programs	
		include:	
		• TRQ allowing value-added rather than yarn-forward rules	
		• An extension of duty-free access to the U.S. market for 10 years,	
		effective October 2008	
		• An extension of eligible woven products from 3 to 10 years	
		• An increase in the TRQ for woven and knit products from 50	

 Table 3.8: Comparative Benefits under U.S. Market Access Programs and Trade Agreements

Program	Description	Eligible exports and rules of origin	Beneficiaries
		million to 70 million square meter equivalents (SME)	
		• Co-production with and direct shipment from the Dominican	
		Republic	
		 Inclusion of luggage, headgear, and sleepwear 	
Haiti Economic	Enacted in May 2010, expands existing	With the exception of the Value-Added TRQ (which expires in	Haiti
Lift Program	preferences for apparel under HOPE II and	December 2018), HELP extends all of CBTPA's and HOPE/HOPE	
(HELP)	establishes new preferences for certain	II/HELP's preference programs through September 2020.	
	nonapparel textile goods	For programs already established by HOPE and HOPE II, HELP	
		enacted the following modifications:	
		 Modified the minimum percentage of value under the Value- 	
		Added TRQ, ranging from 50 percent to 60 percent	
		 Provides a conditional increase of the Woven and Knit Apparel 	
		TRQ quota limits from 70 million SME to 200 million SME	
		 Modified the allowance ratio for the Haiti Earned Import 	
		Allowance Program (see below) from 1:3 to 1:2	
Earned Import	Extends duty-free treatment to apparel	For every two SME of qualifying fabric purchased or manufactured	Haiti
Allowance	products that do not meet the RoO under	by the producer for apparel production in Haiti, qualifying producers	Dominican Republic
Program (EIAP),	HOPE II and HELP—that is, products using	can earn one SME credit. These credits can allow duty-free treatment	
established under	third-party yarn and/or fabric	for imports of apparel manufactured in Haiti using nonqualifying	
HOPE II, modified		fabric. There is no quantitative limit on Haiti EIAP	
by HELP			
Dominican	Supersedes CBTPA for member countries,	For textiles/apparel, most items are still subject to yarn-forward rule,	Costa Rica
Republic-Central	extending duty-free benefits to virtually all	with some exceptions for specific products from selected countries.	Dominican Republic
America Free	goods; also provides provisions to open	Cumulation with Mexico for purposes of RoO is also permitted	El Salvador
Trade Agreement	trade in services		Guatemala
(CAFTA-DR)			Honduras
			Nicaragua
Andean Trade	Enacted in 1991 as part of U.S. efforts to	If apparel is assembled from U.S. fabrics, no quotas or duties apply.	Plurinational State of
Preferences Act	reduce narcotic production and trafficking,	If local inputs are used, duty-free imports are subject to a cap of 2	Bolivia
(ATPA)	it was modeled after the CBI and has	percent of total U.S. imports (increasing to 5 percent in equal annual	Colombia Ecuador
	similar eligibility requirements and product	installments)	Peru
	coverage. ATPA was renewed in 2002 as		
	the Andean Trade Promotion and Drug		

Program	Description	Eligible exports and rules of origin	Beneficiaries
	Eradication Act (ATPDEA) and expanded		
	to include tuna, leather, and footwear		
	products, petroleum products, and apparel.		
African Growth	Passed in 2000, offers beneficiary Sub-	Apparel made from U.S. yarn and fabric qualifies for duty- and quota-	
and Opportunity	Saharan African countries duty free and	free treatment. If regional fabric and yarn are used, there is a cap of	
Act (AGOA)	quota-free market access for essentially all	1.5 percent of U.S. imports, increasing to 3.5 percent over eight years.	
	products, excluding textiles	African LDCs are exempt from all RoO for a limited period of time	

Source: Author's compilation.

2 The Increased Role of Regional Markets for Bangladeshi Exports

3.22 Global merchandise import demand is shifting away from the EU and United States toward China, East Asia, and other middle-income markets. The contribution to global GDP growth of developing countries, including China, India, Brazil, and other big emerging markets, has risen—with Asia figuring as the fastest-growing region of the world. Developing economies have, in turn, become increasingly important export markets in a newly multipolar global economy. Over the past three decades, the import share of emerging markets in world merchandise imports has increased rapidly and in 2010 surpassed that of the United States (figure 3.2). Most impressive has been China's emergence in global demand—a consequence of rapid growth rates and relocation of manufacturing. The secular decline in the share of world imports in high-income countries such as in the EU and United States has accelerated during the recent financial crisis and has been matched by the rise in import shares of emerging markets in Asia, such as China. This process is expected to continue as the high-income countries grapple with the long-lasting effects of the current crisis and with the recovery in capital flows to developing countries from high income countries. Investors will seek to raise returns by investing in countries with stronger fundamentals and growth outcomes.



Figure 3.2: World Imports, 1970–2011

3.23 The rise in emerging markets provides Bangladesh with the greatest opportunity for export diversification efforts. The average factor intensity of Bangladesh's exports against each destination country's income level suggest "there is much more vertical variation at low-income levels than at high-income ones, suggesting that there is more variety in the factor content of Bangladesh's exports to low-income countries" (Cadot and Gourden 2012). For Bangladesh, South-South trade therefore provides more opportunities for export diversification than North-South trade. The Asia region, given both their growing markets and close proximity, provide the greatest opportunities for Bangladesh to diversify and expand exports. Experience suggests that geographic proximity has a powerful positive effect on the volume of trade. Furthermore, other things being equal, the poorest countries increase their trade share with geographically closer partners when trade costs are lower than for more distant partners. A "Look East" strategy, led by India, is bound to have great implications for Bangladesh's long-term trade and growth prospects. Bangladesh's imports from East Asia surpassed the level of bilateral trade with the

United States in 2003; in 2011 East Asian imports were nearly at EU levels and were almost 30 percent of total imports (figure 3.3). In the absence of effective trade agreements with developing countries, the rise of trade with East Asia suggests that the region is becoming the natural trading partner for Bangladesh. As these are mostly imports, Bangladesh is discovering more competitive sources in East Asia relative to the rest of the world.



Figure 3.3: Bangladesh Imports, 1989–2011

3.24 However, Bangladesh's efforts to deepen regional integration have been limited, given its focus on its preferential margins in EU and U.S. markets. Bangladesh has signed five preferential trade agreements and 43 bilateral agreements,⁴⁵ resulting in a complex web of trading (figure 3.4). This structure seems to lack prioritization. These agreements are also rather shallow with selected tariff liberalization for some products, stringent RoO, and limited coverage of broader issues such as standards, investment, services, and labor movements (box 3.2).

⁴⁵ Bangladesh has concluded trading agreements with Afghanistan, Albania, Algeria, Belarus, Bhutan, Brazil, Bulgaria, Cambodia, Egypt, China, the former Czechoslovakia, the Democratic People's Republic of Korea, Germany, Hungary, India, Indonesia, the Islamic Republic of Iran, Iraq, Kenya, Kuwait, Libya, Malaysia, Mali, Morocco, Myanmar, Nepal, Pakistan, the Philippines, Poland, Romania, Senegal, Sri Lanka, Sudan, Thailand, Turkey, Uganda, the United Arab Emirates, Ukraine, Uzbekistan, Vietnam, the former Yugoslavia, Zambia, and Zimbabwe.



Figure 3.4: The Web of Bangladesh's Preferential Trade

Source: Government of Bangladesh.

Note: Single-country boxes represent bilateral agreements. Multi-country boxes represent regional agreements.

Box 3.2: Bangladesh's Free Trade Agreements

Bangladesh is a member of the South Asian Free Trade Area (SAFTA), the FTA created in 2006 by members of the South Asian Association for Regional Cooperation (SAARC). Other SAFTA members are Afghanistan, Bhutan, the Maldives, Nepal, India, Pakistan, and Sri Lanka. SAFTA called for the reduction of intra-bloc tariffs to below 5 percent by January 1, 2009 for non-LDCs; as an LDC, Bangladesh benefits from a phase-out period extended to 2016. Some of SAFTA's members have frontloaded their tariff reductions, including India; Bangladesh has reduced its intra-bloc tariffs by about half compared to 2006 levels. All members maintain sensitive products lists, although their size varies. For instance, Bangladesh has 987 sensitive products, Pakistan 986, but India has only 25.

As an FTA, SAFTA maintains rules of origin (RoO). The general criterion for non-LDCs is a change of tariff heading plus 40 percent local value added, although 191 products have specific rules. That is, in order to qualify for preferential tariffs, a final product assembled in a member state must have an ex-factory price at least 66 percent higher than the total cost, insurance, and freight (CIF) value of its imported intermediates) and it must belong to a Harmonized Commodity Description and Coding System (HS) tariff heading (HS-4 category) different from that of any of its imported components. This local value content requirement is stringent. In many manufacturing activities, in particular ready-made garments (RMG), value addition rarely reaches more than 30 percent of the ex-factory price of the final good. Thus, in the RMG sector, a 40 percent local value content amounts, de facto, to a double-transformation rule; that is, assembling garments from precut fabric under cut, make, and trim (CMT) arrangements does not qualify as sufficient transformation. As an LDC, Bangladesh enjoys a relaxed local-value content requirement (30 percent).^a Cumulating is allowed with 50 percent regional content.

Second, Bangladesh is signatory to the Asia-Pacific Trade Agreement (APTA), together with China, India, Lao PDR, the Republic of Korea, and Sri Lanka. Tariff concessions are so far nonuniversal, with about 40 percent of the tariff lines and 20 percent of regional trade to be covered under the current round of negotiations, launched in 2007. The largest coverage is currently offered by China and Korea and includes jute products and leather goods, both of interest to Bangladesh. The APTA's RoOs are even more stringent than AFTA, with local value contents of 35 percent for LDCs and 45 percent for non-LDCs. The current round of negotiations also aims at broadening the agreement's range to trade in services.

Third, Bangladesh is part of the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) FTA, together with Bhutan, India, the Republic of the Union of Myanmar, Nepal, Sri Lanka, and Thailand. Tariff reductions under the BIMSTEC FTA are planned but have not yet started.

Fourth, Bangladesh belongs to the Developing 8 (D-8) group, which includes also the Arab Republic of Egypt, Indonesia, the Islamic Republic of Iran, Malaysia, Nigeria, Pakistan, and Turkey. A preferential tariff-reduction initiative was agreed upon in 2006 and entered into force in 2011, although with limited coverage (8 percent of all tariff lines). Tariff peaks (above 25 percent) are designated for reductions under the preferential scheme. As an LDC, Bangladesh enjoys longer phase-out periods.

Fifth, Bangladesh is a signatory to the Protocol on Preferential Tariff Scheme for TPS-OIC (PRETAS) protocol of the Organization of the Islamic Conference (OIC), together with Cameroon, Egypt, Guinea, Indonesia, Jordan, Lebanon, Libya, Malaysia, Nigeria, Pakistan, Senegal, Syria, Turkey, Uganda, and the United Arab Emirates.

Note: a. RoOs in the garment sector are no issue for a country like Pakistan with a vertically integrated textile sector. For Bangladesh, were it not for the special LDC regime there could be an issue in the woven-wear sector which has only weak backward linkages (because weaving machinery is expensive), although not in the knitwear sector where backward linkages are stronger.

3.25 An evaluation using the trade complementarity index (TCI) suggests that Bangladesh's export capabilities have only weak complementarities with its partners' import structures (table 3.9). Complementarity has the potential to increase with a more diversified and dynamic Bangladeshi export base. Trade also has potential to grow if neighboring regions start exchanging similar product lines and deepen their production relations. In fact, the smaller export shares (of total exports including the United States and EU) to East and South Asia obscure true growth potential. In addition, there are real policy barriers restricting regional trade, particularly in South Asia. Conversely, Bangladesh has significant

import complementarities with key members of the Association of Southeast Asian Nations (ASEAN), China, and India. They are comparable to Eastern European countries' complementarities with developed EU members (Germany, France, and the United Kingdom) prior to joining EU (a TCI in the region of 60).⁴⁶ Bangladesh maintains the highest levels of import complementarity with Indonesia, India, Malaysia, Thailand, Singapore, and China, owing to the high degree of sourcing of textiles for the RMG sector (figure 3.5). Although prospects for growing existing exports to East Asia may be weak on the basis of export complementarity, dynamic, medium-term impacts may give rise to new export industries, such as the export of processed foods that are currently domestically oriented.

SAFTA countries	Complementarity with Bangladesh (TCI 2010)	Imports in US\$ 000's
Bhutan	29.56	854
Nepal	27.17	5,127
India	19.68	341,000
Maldives	19.57	1,095
Sri Lanka	18.70	12,400
Pakistan	18.15	37,500
Simple average	22.14	
Import-weighted average	19.62	

Table 3.9: Trade Con	plementarity	Indices,	Bangladesh	versus SAFTA	Partners	2010
						,

Source: Calculations using UN-COMTRADE data.

Table 3.10: 7	Frade Com	plementarity	Indices.	Bangladesh	versus Al	PTA Pa	rtners. 20	10
		p						

APTA countries	Complementarity with Bangladesh (TCI 2010)	Imports in US\$ 000's
India	19.68	341,000
Korea, Rep. of	22.47	425,000
Sri Lanka	18.70	12,400
Simple average	20.28	
Import-weighted average	21.19	

Source: Calculations using UN-COMTRADE data.

TCij = 100—sum $(|m_{ik} - X_{ij}|/2)$

⁴⁶ The trade complementarity index (TCI) can provide useful information on prospects for intraregional trade. It shows how well the structures of a country's imports and exports match. Furthermore, countries considering the formation of a regional trade agreement can examine the TCI values of others that have formed or tried to form similar arrangements. The TCI between countries k and j is defined as:

Where xij is the share of good i in global exports of country j and mik is the share of good i in all imports of country k. The index is zero when no goods are exported by one country or imported by the other and 100 when the export and import shares exactly match.

BIMSTEC countries	Complementarity with Bangladesh (TCI 2010)	Imports in US\$ 000's
Bhutan	29.56	854
Myanmar	30.99	4,164
Nepal	27.17	5,127
Thailand	21.35	180,000
Simple average	27.27	
Import-weighted average	21.75	

Table 3.11: Trade	Complementarity	Indices, Ba	ngladesh versus	BIMSTEC Partners	, 2010
					,

Source: Authors calculations using UN-COMTRADE data.



Figure 3.5: Bangladesh's Import Complementarity with India and East Asia, Selected Years

Source: Authors calculations using UN-COMTRADE data.

3.26 With less than 15 percent in both services imports and exports, Bangladesh has the lowest share in trade in services among South Asian countries (Reihan 2010). Lack of regional trade is not due to the absence of complementarities. Bangladesh shares a specialization in transport services, and an emerging specialization in business services, with Pakistan and Sri Lanka; it has complementarities with Maldives and Nepal in travel services; and with India in information and communication technology (ITC) services (Reihan 2010). What curtails trade is the level of protection of services, which tends to be higher than the protection on goods trade. Informal trade is not uncommon among countries sharing borders with high protection in services. For example, there are suspected unofficial flows and low official trade flows between India and Bangladesh in education and health-related services. This suggests that there are prospects for gains if barriers are dismantled (De, Raihan, and Kathuria 2012).

Bangladeshi merchandise exports would be 52 percent higher and the country could gain around US\$1.8 billion from broader South Asia–East Asia integration. Export growth to East Asia has the greatest potential. A recent formal analysis using computable general equilibrium (CGE) modeling confirms that broader South Asia–East Asia integration that includes all members of South Asia would provide large gains to exports and trade, and overall welfare, for Bangladesh (Francois, Rana, and Wignaraja 2009). Bangladesh's gains would have little effect, positive or negative, on outsiders. Note that these results only

illustrate the possible direction of the static gains to Bangladesh. All CGE static gain analyses considerably understate growth impacts, because the models incorporate limited dynamic effects from cross-border investment flows in support of trade. Such cross-border investment would be a much bigger factor for countries like Bangladesh. Moreover, such opening to investment could raise economy-wide productivity and scale economies of domestic firms and industries (by increasing capital to an increased supply of labor unit costs are decreased).

3.27 Bangladesh also has the potential to increase trade with South Asia. Under SAFTA, Bangladesh has secured a reduced sensitive items list and accelerated duty-free treatment for almost all items (except a few that is still remaining) that are now subject to tariff-rate quotas). Traders experience a modest level of non-tariff barriers, including a 4 percent import cess on the RMG sector, rebated to domestic traders from different states. Other actions likely to yield significant dividends for Bangladeshi exporters include building product quality standards and related infrastructure; an ongoing effort by the Indian Bureau of Standards to upgrade the Bangladesh Standards and Testing Institution (BSTI); and mutual recognition agreements (MRAs) between the two countries. SAARC also provides a forum to address regional MRAs. Bangladesh's Federal Bureau of Chambers has raised a number of other policy-related issues that have hindered the movement of goods at the border with India (see box 3.3).

Box 3.3: Policy Barriers at the Bangladesh-India Border

Selected issues identified by the India-Bangladesh Chamber of Commerce and Industry with regards to trade flows at the border with India include the following:

- Absence of a clear transit protocol at Land Customs Stations (LCS)
- Lack of standards and specifications at LCS
- Only certain land ports authorized for export of soap to India
- Lack of standards for commercial vehicles and lack of recognition of licensed drivers
- Six permissions required from Indian agencies to export goods to Kakarvitta in Nepal via India
- Lack of recognition of insurance policies

Source: India-Bangladesh Chamber of Commerce and Industry.

3.28 There is no consensus on the implications for Bangladesh of free trade in goods under SAFTA. A CGE model simulation by Francois, Rana, and Wignaraja (2009) of full free trade among South Asian countries points to a welfare gain for Bangladesh of about US\$514 million over the baseline. Raihan (2010) and Bout et al. (2010) suggest welfare losses to Bangladesh from potential free trade under SAFTA, largely due to trade diversion outweighing the trade creation effect. However, Raihan (2010) shows a 50 percent reduction in MFN tariffs with full liberalization under SAFTA, which would mitigate the negative effects of trade diversion and improve welfare.

3.29 However, estimated gains from trade facilitation between Bangladesh and India are much bigger than the gains from trade liberalization. For example, a study by De, Raihan, and Kathuria (2012) suggests that, due to the size and proximity of the countries, a Bangladesh–India FTA could increase exports to India by about 134 percent; with improved connectivity,⁴⁷ Bangladesh's exports to India could increase about 297 percent. Improvements in connectivity provide the largest payoff in merchandise trade, and the spillovers could facilitate trade with third countries. These estimates are based on existing trade patterns and, therefore, represent a lower bound of the potential increase in Bangladesh's exports arising from an FTA. The potential gains from trade with India under SAFTA are also only likely to be realized

⁴⁷ To capture the improvement in connectivity, a 25 percent drop in the bilateral trade-cost margin between Bangladesh and India is simulated.

through joint efforts to reduce nontariff barriers to trade, especially with respect to standards and the transaction costs at and behind the border. Working towards mutual recognition of product standards should constitute a priority. Likewise, joint efforts to address procedural delays at the land borders can enhance trade relations. Chapters 6 and 5 on Trade Facilitation and Standards provide concrete recommendations on measures that can facilitate trade between the two partners. Furthermore, the experience of the India–Sri Lanka FTA shows that, beyond the exchange of preferences, the agreement has provided a "boost of confidence" in the private sector, resulting in substantial new investments by India in Sri Lanka's service sectors (box 3.4).

Box 3.4: India–Sri Lanka Free Trade Agreement

Sri Lanka's regional trade, particularly with India, has undergone a significant increase compared to regional neighbors. Sri Lanka's share of intraregional imports rose from 11 percent in 2000 to 23 percent in 2008 and its export share rose at a higher rate, from a very low 2.7 percent in 2000 to 8.5 percent in 2008 (Pitigala 2010). Since the India–Sri Lanka Free Trade Agreement (ISLFTA), Sri Lanka's bilateral exports with India, traditionally small, have soared compared to the other nonlandlocked countries, and relative to growth levels of Indian overall imports.

There are a number of reasons behind the success. First, the ISLFTA, although principally an agreement on trade in goods, also boosted the services trade and foreign direct investment (FDI). For example, India joined the top five providers of FDI, with cumulative investment of US\$1 billion since 2003 and a lot more on the way. A liberal bilateral aviation regime between the two countries has meant that Indian tourists account for one fifth of Sri Lanka's total foreign arrivals. Also, 70 percent of the business of Colombo port is accounted for by cargo to and from India.⁴⁸

The scope of product coverage was also enhanced by a "negative list" approach. Finally, a faster pace of implementation was used. For example, within three years of signing, duty-free access was granted by India on 81 percent of the agreed items, and similar reciprocity was pursued by Sri Lanka. Fourth, RoO were simplified. In practice, for India, ISLFTA is more liberal than the South Asian Free Trade Area (SAFTA), given the somewhat lower domestic value added criterion. For Sri Lanka, with the exception of the products subject to specific RoO under SAFTA, both agreements provide for a similar level of market access, though ISLFTA provides for a more favorable framework for production sharing with India through the cumulative rules.

Source: Dasgupta, Pitigala, and Gourdon 2012.

3.30 A bilateral FTA between Bangladesh and India should also incorporate services. Steps that can reap immediate benefits include dismantling barriers to entry of service suppliers and users, help formalizing education and health-related areas. In both India and Bangladesh, easing entry conditions and encouraging formal movement of students by issuing, for example, long-term multiple-entry visas can boost cross-border student traffic. The Bangladeshi government should help Indian universities and educational institutions set up branches in major cities in Bangladesh. Facilitating temporary movement of health of health, education, and ICT professionals, could also benefit services trade and help lay a framework for deeper integration. These steps could also attract more investment from India. Whether investment ventures were 100 percent Indian or joint ventures, they would help improve Bangladesh's export supply capability and boost exports to both the region and the outside world.

3.31 Lagging border regions of Bangladesh, among the poorest in South Asia, need to be part of the new market expansion to help reduce poverty. In Bangladesh, the border districts tend to have lower than average per capita income, higher than average poverty, and poorer human development. Weak regional cooperation has hurt the poor more than other segments of the population. Regions that share a border with India are largely disconnected from the national economy and lack the market linkages and

⁴⁸ See interview of Indian High Commissioner: http://www.sundayobserver.lk/2013/05/12/fea04.asp

infrastructure to formalize trade. Alternative bilateral and regional mechanisms, including cross-border bazaars and related facilities, can operate in parallel with FTAs to extend local market opportunities. Cross-border trade—defined as the flow of goods and services up to 30 kilometers across international land borders—is important to the prosperity of border communities.

3.32 The "haat" program (a haat is a border trading area or bazaar) helps to ease the movement of goods and people across the India-Bangladesh border. The haat program should be expanded beyond its harvest-time trade in subsistence farming products, and the 10-mile limit of trading should be expanded. This would encourage the development of post-harvest infrastructure that would reduce harvest waste and increase returns to local communities. Participation in bazaars should be made easier (for example, through visa-free entry). Both governments should explore replicating the Korgas model for existing and new haats (box 3.5).

Box 3.5: Historical Role of Bazaars

Bazaars have played a vital and historic role along the India-Bangladesh border. Bazaar trading is the primary channel for cross-border trade in many regions. In 2011, the governments of Bangladesh and India revived the border bazaar concept and opened a pilot haat near the Kurigram/Meghalaya border. Additional bazaars were subsequently opened, which are permitted to sell local agricultural and horticultural products, spices, minor forest products (excluding timber), fresh and dry fish, dairy and poultry products, cottage industry items, wooden furniture, handloom and handicraft items. All sales are exempt from local taxes. By strengthening commercial ties, promoting cultural understanding, and deepening community relationships, cross-border trade nurtures amicable border relations.

Geographical and sales restrictions should be relaxed. This would help create economies of scale and encourage a post-harvest infrastructure to reduce wastage and increase returns to local communities. While the haat program is a step in the right direction, it currently provides limited opportunities for local communities to expand beyond subsistence farming and toward sustainable trade development. Under existing rules, production must come from a very small radius (5–10 kilometers)—within which there is little industry on the Bangladeshi side of the border—and sales are limited to US\$50 per person. The experience of other border bazaars suggests that relaxed entry procedures for vendors and buyers, and tariff rate quotas on small quantities, could encourage the growth of the haat. Such policies and facilities could provide needed services, expand the reach of local markets, create a direct stimulus for income generation and employment, and reduce poverty among households and small businesses in the border regions. This would promote the transition from subsistence-level farming to small-scale commercial farming.

The Korgas bazaar, on the Kazakhstan–China border, is an exemplary case study. It is one of the region's largest cross-border bazaars, servicing some 1,300 traders per day. The bilateral regime allows visa-free entry for traders entering for the day and limited duty-free privileges (on up to US\$1,000 of cargo, with a flat rate applied thereafter). On the Kazakhstani side of the border, cross-border trading has become the most important source of employment in Jarkent, the largest border city in the district. Conservative estimates indicate that 10 percent of the local population work directly in cross-border trade activities. Estimates suggest that each trader generates employment for an additional one to two persons engaged in warehousing, local transport, or sales within the bazaar. The existence of the bazaar has also generated spillover effects, creating new retail and other commercial opportunities (Kaminiski and Mitra 2010.)

3 Integrating into Production-Sharing Networks

3.33 Bangladesh has yet to exploit regional production-sharing potential. Beyond the static comparisons of complementarity is, however, the much greater potential for Bangladesh to integrate with global manufacturing (and services) value chains at the labor-intensive stage. Countries are now increasingly engaged in production sharing as means of product and market diversification (Pitigala 2010). As suggested by Sally (2010), Bangladesh has failed to insert itself into global manufacturing supply chains, processing trade supply chains, and other ICT supply chains (beyond textiles and garments). The drivers of global trade go beyond relative factor endowments, to factors such as complementary use of ICT and natural geographies (clustering, agglomeration, and scale effects). The effects can be powerful enough to increase trade impacts by a factor of two or more (Hoekman and Nicita

2008). To replicate its RMG success, Bangladesh needs to address the fundamental drivers of global chains, such as lowering the trade costs and barriers to service. Regional services and cross-border investment in services can be a powerful engine for easing these constraints endogenously. Recent evidence has established a two-way relationship between regional agreements and production sharing (Orefice and Rocha 2011). The results show that, on average, "deep" trade agreements increase production sharing–related trade between member countries by approximately 35 percent, with the highest impacts in the automotive, information, and technology product sectors.

3.34 Tariffs are an important determinant for the success of firms engaged in production sharing. For example, a 1 percent reduction in customs duty is associated with a 0.3 percent increase in exports. Using Bangladeshi firm-level data for 2008–10, we examine how customs and supplementary duties impede exports. Total figures are calculated for each firm for export and import variables. Exports are regressed on various import impediment variables like customs duties, supplementary duties, and controls for the customs value of total imports. Import exemptions (such as duty drawback and export processing zones) are introduced as dummy variables.⁴⁹ The results are an attempt measure import impediments at the border that may have an effect on exports. Figure 3.6 displays the relationship between customs duties paid (excluding other taxes) and exports.



Figure 3.6: Customs Duties versus Level of Exports in Bangladesh

Source: Author's calculations using Bangladesh Customs data.

3.35 Regression results show that the level of customs duty has a strong negative effect on firms engaged in production sharing—that is, firms reporting both imports and exports. The customs duty rate and supplementary duty rate also have a negative, but statistically insignificant, relationship to firm-level exports. As expected, exemptions from applicable duties have a strong positive relationship to exports (see annex A, table 3A.1).

3.36 Demographic shifts and rising labor costs in China create opportunities for production sharing. While both China and India are rapidly emerging as potential new markets for regional exports—including from Bangladesh—large demographic shifts in the region, especially in China, are expected to create new patterns of production and trade within existing global production networks. China emerged in

⁴⁹ Exemptions conferred by preferential trade agreements were excluded from the analysis to focus specifically on domestic exemption policies.

the 1990s as a low-cost manufacturing powerhouse, driven by the special economic zones, open coastal cities, and other incentive regimes; it had a comparative advantage in labor-intensive manufacturing, particularly basic assembly operations. However, this advantage is being rapidly eroded due to the country's slow population growth and rising wage pressures. China, like most countries in the East Asia region, is expected to experience a decline in their working age population. As population growth slows in China, the hardest hit will be the lower-skilled labor market, which had already begun to shrink in 2004. In 2010, more than 4 million low-skilled workers entered the labor force. By 2020, new entrants in this segment will shrink to 1.5 million (figure 3.7). Hence, the comparative advantage of the economy will skew towards higher-skilled intensive manufacturing and services.





3.37 China's increasing labor costs are creating new opportunities for Bangladesh. Together with the shrinking labor pool, wages have increased by 15 to 25 percent per year since 2005 in key manufacturing and business centers, putting cost pressure on lower value–added activities within China's production chains (figure 3.8). China is expected to continue its shift toward more skill-intensive production and services. Thus, lower-wage destinations have a historic opportunity to break into the global production networks and capture a share of China's traditionally labor-intensive manufacturing industries, such as clothing, footwear, and basic electronics assembly. Moreover, while China's interior and western provinces offer an abundance of lower-cost and skilled labor, other low-wage countries in Asia, particularly those with growing labor forces (the so-called "demographic dividend"), have an opportunity to benefit from China's demographic shift.

3.38 Two factors might prevent Bangladesh from fully exploiting spillovers from China's rising wages. First, although average wages in Bangladesh are on par with other low-wage countries in Southeast Asia, Bangladesh will be at a disadvantage with the implementation of the China-ASEAN FTA, which will immediately benefiting low-income countries such as Vietnam and Cambodia (figure 3.9). Second, rising labor costs in China are offset, to some degree, by its increasing productivity and availability of supply chains within China that may not be easily replicated by Bangladesh, except in the textiles and apparel sector. Nevertheless, there is anecdotal evidence that some opportunities will arise, such as the case of a wire manufacturer that moved to Bangladesh from China (*Economist* 2012). In any case, the private sector and the government of Bangladesh need to devise a coherent strategy to exploit such opportunities.

Source: NBS, Ministry of Education, World Bank Group, United Nations Population Division and Deloitte China Manufacturing Competitiveness Study 2011



Figure 3.8: Rising Wages in Key Geographic Nodes in China, 1985–2010

Source: China National Bureau of Statistics.





Sources: Bangladesh Export Processing Zone Authority; China National Bureau of Statistics; Economist Intelligence Unit.

3.39 Bangladesh has also begun export diversification, albeit slowly, which could lead to new opportunities in major industrial markets. Through a GIZ initiative, the country looked at a set of nontraditional markets that could be reached by diversifying the RMG portfolio, including Brazil; Hong Kong SAR, China; Japan; the Russian Federation; South Africa; and Turkey. They vary in size, domestic competitiveness, climatic zone, and geographical proximity. In 2008, these countries' combined market in woven apparel was US\$35 billion, and accounted for 64 percent of total imports from nontraditional countries. Japan's recent relaxation of its GSP RoO has already provided a boost to RMG exports. Other exports, such as seafood, are at a nascent stage, constrained by fairly stringent quality and safety requirements. Bangladesh can benefit from Canada's Least Developed Country Initiative (LDCI),

launched in 2003, as the quality standards are similar to those in the United States.⁵⁰ In the case of other products, like shrimp, additional measures will be needed to realize the opportunities created by the LDCI, including quality that complies with Canadian product standards. There is no evidence that Canadian standards are unnecessarily high, relative to United States and the EU.

4 Export Promotion in Bangladesh

3.40 Bangladesh's Export Promotion Bureau (EPB) can play a critical role in strategically promoting exports. Countries increasingly rely on specialized agencies such as EPB in implementing export strategies, designed principally to assist and encourage domestic firms to export goods and services and increase their foreign sales. The role and effectiveness of export promotion agencies (EPAs) has been studied using different methodologies,⁵¹ and while country-specific studies offer valuable insights, they cannot be generalized. The World Bank global survey of EPAs across the world provides a rich source of information for analysis. This section briefly summarizes the key issues and performance of Bangladesh's EPB. We then compare EPB to other EPAs through a set of key criteria, including structure, responsibilities, strategic objectives, resources and expenditures, and monitoring and evaluation systems (Lederman, Olarreaga, and Payton 2010).

3.41 EPB could improve its effectiveness by giving the private sector more representation on its board, given empirical research showing that such representation increases EPA efficacy (Lederman, Olarreaga, and Payton 2010). Like many EPAs, EPB is an autonomous agency, financed by the public sector; however, EPB has less private sector representation on its board (28 percent) compared to EPAs in countries with similar income (at least 40 percent). Moreover, EPB's board has 14 members, higher than the world and regional average of 10 board members. In terms of its legal status, EPAs' efficacy seems to rise with public funding, but there is no evidence of increased performance due to a specific legal status.

3.42 EPB has a broad mandate with limited resources. Apart from the main functions of export and investment promotion, EPB oversees export financing and tourism promotion. EPAs often have more than one responsibility, but promotion of tourism is usually not mentioned by other EPAs. The synergies between export promotion and investment attraction are more evident than with tourism promotion—with the exception of country image building, an activity in which EPB is not engaged.

3.43 EPB's strategic objectives are much more narrowly defined than typical EPAs. Like all EPAs surveyed, EPB is principally focused on product and market promotion. Generally, market diversification takes precedence over product diversification for most EPAs. It is also not uncommon for modern EPAs to engage in strategic objectives such as the attraction of export-oriented multinationals, the development of clusters, and inclusion in global supply chains. However, EPB did not rank any of these latter strategies (value chain, clusters, or attraction of multinationals) in its response to the World Bank survey. Given the shifting global dynamics of manufacturing, including the demographic deficit and ensuing costs in China, EPB could be in a pivotal position to devise strategies through brand image to prop up relative country advantage and exploit production-sharing opportunities.

3.44 Image building and policy advocacy are strong functions in many EPAs, but not in Bangladesh. EPB seems to be pursuing its objectives mainly though marketing services, which account for 50–75 percent of its budget. Less than 10 percent of its budget is allocated to technical assistance and country image building. The marketing services' effectiveness is undetermined, because EPB does not conduct

⁵⁰ Canada improved market access for LDCs by abolishing all tariffs and quotas on imports from LDCs, with the exception of dairy, poultry, and eggs. The scheme also offers generous RoO.

⁵¹ These include qualitative case studies (Kotabe and Czinkota 1992); econometric analysis with cross-country data (Lederman, Olarreaga, and Payton 2010); and, more recently, impact evaluation methods using firm-level data for specific countries (Cadot and Gourden 2012; Volpe 2011; Volpe and Carballo 2010).

formal follow up with its clients or track key performance indicators. By contrast, about 80 percent of surveyed EPAs have a formal process to follow up with clients that received assistance from them, and the same share of EPAs reported having their own impact measurement mechanisms. EPB does, however, monitor four key performance indicators: client satisfaction, number of exporters, value of exports, and number of clients. Some EPAs invest a small amount (10 percent or less of budget) on policy advocacy aimed at improving the business environment and access to foreign markets. However, EPB is not involved in such activities. Lederman, Olarreaga, and Payton (2010) found that EPAs seem to be more effective at improving the business environment when they advocate for the removal trade barriers abroad, or when they help correct information asymmetries resulting from a large share of heterogeneous goods in the export bundle.

3.45 EPB, with an average budget of US\$3.1 million, spends slightly less than EPAs in Asian countries and LDCs in general. Survey data analysis shows a positive correlation between EPAs' budget and the level of exports of the country (figure 3.10), as well as the number of products the country exports (Lederman, Olarreaga, and Payton 2010). EPB spends 50–75 percent of its budget on the garments/leather/textiles sector (table 3.12). This pattern seems to be aligned with EPB's strategic objective (as of 2010) of diversifying exports by encouraging new destinations. However, EPB also aims to diversify exports by encouraging new products, including pharmaceutical products, ICT, ship building, and leather footwear. The relative concentration of expenditures on the garments/leather/textiles sector also seems to contradict the priority objective of promotion exports of all sectors.



Figure 3.10: Correlation between EPA Spending and Export Volume

Source: Lederman, Olarreaga, and Payton 2010.

Note: Lowess smoother applied to scatterplots (bandwidth = 0.8).

	Share of total	Number of		
Sector	Mean (%)	Bangladesh (%)	respondents	
Agriculture, agro-industry, and animal products	10–25	0	67	
Garments/leather/textiles	~ 10	50-75	65	
Other manufactures	~ 10	0	60	
Machinery	~ 10	10–25	64	
IT services	~10	0	65	
Skill-intensive IT services	~ 5	0	63	
Tourism	~5	0	62	
Other	~5	0	56	

Table 3.12: Budget Allocations in EPAs

Source: World Bank, 2010.

5 **Recommendations**

3.46 **Augment competitiveness as the basis for greater and durable market access.** Preferential market access in Bangladesh's primary export markets, such as the United States and EU, is determined unilaterally by their partners. This puts Bangladesh at a disadvantage in terms of influencing the level of preferential access. Coalition building to influence duty free/quoata free access for LDCs in the U.S. market may continue as a supplementary effort rather than the norm. At the same time, Bangladesh's ambition of attaining middle-income status while maintaining higher protection is at odds with its continued reliance on LDC status as means of securing market access. A more forward-looking, sustainable strategy would focus on robust interventions within Bangladesh to reduce logistics costs, eliminate anti-export biases in tariffs and tax policy, and improve the regulatory environment to facilitate investment. Such actions are a more sustainable means to overcoming Bangladesh's preferential disadvantage in U.S. and EU markets and ensure long-term competitiveness in both the RMG and non-RMG sectors.

3.47 Diversify export markets beyond the United States and EU to incorporate other Organization for Economic Co-operation and Development (OECD) and developing countries. Bangladesh's marketing activities are largely focused on United States and EU. The new export diversification agenda should focus on OECD countries, including Japan and Canada and LDCs, including Brazil, India, South Africa, and Turkey. Note that Bangladesh's exports to other LDCs are more diversified than exports to high-income countries. One of the primary barriers to new export market discovery is the lack of adequate market information (including market entry requirements, prospective buyers, and so forth), especially for small and medium enterprises. The costs of gathering information about opportunities in new export markets may be very high for a developing country, as only a few of its firms will export to that new market at first. Any rents will be captured by new entrants. The EPB can play a critical role in this respect by collecting and disseminating market information as a public good—but it currently lacks adequate capacity.

3.48 **Explore opportunities for production sharing beyond the RMG sector.** Shifting production and trade patterns have created opportunities for new low-cost entrants into existing global production-sharing networks linking the dominant Asian exporters. Bangladesh's potential entry into such networks depends a number of factors that are discussed above under trade policy and trade facilitation. Recommendations include steps to improve the effectiveness of port logistics and reduce tariff barriers to improve the allocation of resources, reduce transactions costs, and increase participation in global value
chains. These policy measures should be backed by a coherent image-building effort to highlight Bangladesh's comparative advantage in labor-intensive manufacturing.

3.49 **Improve the efficacy and capabilities of EPB**. Increasing the number of private sector representatives on the board from four to seven will bring EPB close to the global average for private sector seats (50 percent). EPB should consider including representatives from beyond the traditional RMG sector to include the "new sectors" toward which Bangladesh aims to diversify (such as pharmaceuticals, shipbuilding, ICT, and leather footwear). EPB could also address a current weakness by establishing a formal, in-house monitoring and evaluation mechanism to follow up with its clients, track key performance indicators, and monitor the export outcomes of trade missions. With the data collected, it will be possible to target the most relevant trade fairs in terms of export contracts signed.

3.50 Stronger commercial intelligence and diplomacy could help unlock opportunities in market access negotiations. There is consensus that capacity for commercial diplomacy⁵² is rather weak among key officials in Bangladesh. Commercial Diplomacy is an area that complements the training needs addressed in Chapter 4 on institutions. The targeted audience for commercial diplomacy typically constitutes senior officials (Directors and Additional Secretaries and commercial officers) of institutions most directly engaged in negotiations, such as MoC and MOFA, BTC, and BFTI. A more comprehensive audience for commercial diplomacy (as conducted in India) includes Chambers, key business officials, and Think Tanks-all stakeholders engaged in inter-ministerial sub-committees on market access negotiations. Bangladesh can certainly benefit, in the interim, from training program targeted at key government agencies. There are a number of reputed international institutes such as Institute for Trade and Commercial Diplomacy (ITCD), and World Trade Institute (WTI), both specializing in the development of training materials in Commercial Diplomacy. The training generally entails a modular form and should cover, at a minimum, the following elements: (i) Provide a comprehensive perspective of the global economic system and how it affects trade and investment flows; (ii) Explain principles and processes of Commercial Diplomacy and contrast with traditional diplomacy; (iii) Impart basic negotiation skills; (iv) Provide exposure to negotiation processes through conducting real case analysis/ simulation of trade negotiations; and (v) Explaining the nuances involved in drafting an effective resolution/agreement.

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⁵² Commercial diplomacy is defined as the application of the tools of diplomacy to the removal of barriers to trade and investment, and to the resolution of policy conflicts arising from the globalization of the world economy

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Annex A	. Regression	Results
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Table 3A.1. OLS Panel (Exporters and Nonexporters)		
Variables	Ln_exports	
InCustom_Value	1.325***	
	<mark>(-0.0877)</mark>	
InCustoms_Duty	-0.304***	
	(-0.0751)	
CD Rate	-0.0044	
	(-0.0188)	
SD_Rate	-0.000151	
	(-0.0007)	
Exemption	1.993***	
-	<mark>(-0.213)</mark>	
Constant	_0 222***	
Constant	-9.232***	
	(-0.999)	
Observations	7,750	
R-squared	0.094	
Note: Standard errors in parenthe	eses, *** p<0.01, ** p<0.05, * p<0.1	

Table 3A.2: Regression Results (Exporters)		
Variables	Ln_Exports	
InCustom_Value	1.223***	
	<mark>(-0.0876)</mark>	
InCustoms_Duty	-0.239***	
	(-0.0734)	
CD_Rate	0.127***	
	(-0.0205)	
SD_Rate	-0.0000724	
	(-0.000847)	
Exemption	1.753***	
1	<mark>(-0.213)</mark>	
Constant	-10 23***	
	(-1.025)	
Observations	6792	
R-squared	0.098	

Note: Standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	InAssessableValue_ex		
Variables	2008	2009	2010
InCustom_Value	1.439***	1.289***	1.243***
	(-0.153)	(-0.153)	(-0.15)
	0 (21***	0.170	0.140
InCustoms_Duty	-0.621***	-0.169	-0.148
	(-0.13)	(-0.133)	(-0.128)
CD_Rate	0.0281	-0.227*	0.02
	(-0.0238)	(-0.12)	(-0.0376)
SD_Rate	0.000159	0.00641	-0.000695
	(-0.00111)	(-0.00472)	(-0.00114)
Exemption	1.481***	2.557***	1.991***
	(-0.371)	(-0.372)	(-0.363)
Constant	-7.132***	-5.27	-11.11***
	(-1.641)	(-3.307)	(-1.745)
Observations	2570	2501	2679
R-squared	0.07	0.111	0.095

Table 3A.3	: Assessable	Value of	of Exports
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Note: Standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1

CHAPTER 4

Leveraging Institutions for Trade Development in Bangladesh

4.1 Policy makers confront an increasingly larger and more complex trade agenda. National decisions on trade policy involve a range of public institutions and agencies, all of which need to work together to address challenges posed by the new trade agenda and ensure that policies contribute to development. Continuous consultation and consensus building among ministries and agencies involved in trade policy making and negotiations is essential for effectively responding to opportunities and challenges presented in the international trading environment. Furthermore, the consultative process needs to be broad based as a prerequisite for to good economic governance.

4.2 Although Bangladesh's Sixth Five-Year Plan and Vision 2021 recognize the critical role of trade and export diversification for economic development, actual policies are often at odds with this overall vision. This can be attributed, at least in part, to the fact that trade policy is carried out through a number of institutions in a piecemeal fashion. This fragmentation is exacerbated by the absence of a national trade strategy that could otherwise provide an overarching mandate in the formulation of each institution's individual policies. There is a lack of adequate recognition of how economy-wide costs of protective trade barriers and other domestic policies have potentially countervailing effects on other policies designed to promote industrialization and exports. The development of an effective trade policy architecture that addresses these effects requires an efficient and capable institutional structure and coordination mechanisms.

4.3 This chapter has three main objectives. First, we assess the process of policy making and implementation (including interagency coordination), identify gaps and frictions that exist in the system, and assess the capacities of existing organizations to undertake their mandated functions. Second, we suggest actionable interventions in terms of an effective institutional framework. Third, we elaborate on the associated capacity-building efforts that are required to support an effective trade policy formulation and implementation.

4.4 The key messages of this chapter are as follows:

- Trade policy considerations have been dominated by fiscal ones in the process of tariff setting.
- There is no uniform model of trade policy formulation. However, effective structures should allow good quality interagency coordination, consultation among stakeholders, and research and evaluation.
- In terms of interagency coordination, a merger of export and import policy wings and strong coordination with the Ministry of Industries could significantly improve the consistency of trade policy. This should also help balance exporting and domestic production interests.
- Widening stakeholder consultations and making them more transparent can improve acceptability and efficacy of trade policy. A high-level competitiveness council or similar body can help to embed trade policy within a competitiveness agenda. The existing Business Initiative Leading Development (BUILD) framework can be used to address trade-related regulatory issues. And open and transparent tools should be used to widen and legitimize stakeholder consultations.
- Strengthening research and analysis of trade policy formulation and the impact of trade policies would require the following actions: (i) involvement of think tanks throughout the policy-making

lifecycle; and (ii) building up capacity of the Ministry of Commerce (MoC) for basic research, and strengthening it through appointment of an economic advisor to help direct trade policy formulation, engage with think tanks, and so forth.

• Capacity-building efforts should focus on key institutions. Within the MoC, trade-related training, moving staff positions from administration to trade-related wings, and providing in-house legal capability are priorities. The Bangladesh Foreign Trade Institute (BFTI) can be developed as a training institution. The Bangladesh Tariff Commission (BTC) could focus on antidumping and safeguard issues.

1 Trade Policy Institutions

4.5 Trade policy formulation in Bangladesh is fragmented. Policies are not linked and there is not a clearly defined focal point for implementing a unified framework. In terms of the official mandate, the principal responsibility of domestic and international trade in Bangladesh rests with the MoC. The Imports and Exports (Control) Act of 1950 empowers the MoC to regulate the import and export of goods and services. MoC regulation proceeds through a periodic Import Policy Order that encompasses a range of nontariff barriers (NTBs) (such as quotas, import controls, licensing), and Export Policy that provides for incentives and other schemes. In addition, the MoC is the focal point of bilateral, multilateral, and regional negotiations and for ensuring Bangladesh's compliance with World Trade Organization (WTO) Agreements, including dumping, safeguards, and countervailing duties. The MoC implements the policies through a number of agencies under its purview: the BTC, the Export Promotion Bureau (EPB), the office of the Chief Controller of Imports and Exports (CCIE), the BFTI, the Trading Corporation of Bangladesh, and the Business Promotion Council.

4.6 Under the Ministry of Industries, the Bangladesh Standards and Testing Institute (BSTI) is the main body on technical standards and the Department of Patent Designs and Trademarks deals with patents, industrial designs, and trademarks. Under the Prime Minister's Office, key agencies are the Privatization Commission, the Board of Investment, and the Bangladesh Export Processing Zones Authority. The Ministry of Industries also offers a range of incentives under its industrial policy.

Trade policy measure	Primary policy/instrument	Primary agency responsible
Tariffs	Fiscal	MoF (NBR)
Nontariff barriers (quotas, licensing, etc.,)	Import Policy Order	MoC
Subsidies	Export Policy, textile policy, industrial policy	MoC/NBR/MOTJ/MOI
Standards (SPS/TBT)	Technical standards, food safety and animal health standards, Import Policy Order	MOI (BSTI)/MoC/MOHFW/MOA
Antidumping and trade remedies	Antidumping and safeguard rules under the Customs Act	MoC (BTC)
Market access (WTO, RTA, etc.)	Export Policy	MoC
Trade in services	None	No focal point

Table 4.1: Bangladesh Institutions and Their Mandated Roles and Responsibilities, 2012

Note: BSTI = Bangladesh Standards and Testing Institute; BTC = Bangladesh Tariff Commission; MOA = Ministry of Agriculture; MoC = Ministry of Commerce; MoF = Ministry of Finance; MOHFW = Ministry of Health and Family Welfare; MOI = Ministry of Industries; MOTJ = Ministry of Textile and Jute; NBR = National Board of Revenue; SPS = sanitary and phytosanitary standards; RTA = regional trade agreements; TBT = technical barriers to trade.

4.7 The following sections provide a brief overview of the MoC, as the focal point of trade policy, and its two primary policy-related agencies, the Bangladesh Tariff Commission and the Bangladesh Foreign Trade Institute, including their organizational structures and staffing capacities.

4.8 The **Ministry of Commerce**, as the focal point of trade policy, needs highly professional and committed manpower to make the best use of the evolving opportunities in the multilateral trading system. The MoC has a number of wings and cells that are engaged in trade policy making and implementation, each headed by an additional secretary (see annex A, figure 4A.1):

- The *Import & Internal Trade (IIT) Wing* deals with import-related measures and domestic trade issues, including the periodic Import Policy Order, price controls, and implementation matters related to imports.
- The *Export Wing* is responsible for Export Policy formulation, export facilitation, engagement in bilateral trade negotiations, export promotion, compliance monitoring, and monitoring of commercial missions abroad. A *Textile Cell*, operating under the Export Wing, deals mainly with textile and apparel export–related issues.
- The *FTA Wing* is responsible for bilateral and regional trade agreements and liaising with international and multilateral trade organizations (such as the United Nations Conference on Trade and Development [UNCTAD] and the International Trade Centre [ITC]).
- A *WTO Cell*, which operates at the same level as the wings, oversees WTO-related negotiations and capacity building for stakeholders on WTO rules and regulations. The *Directorate of Trade Organization* is responsible for relationships with trade bodies, including chambers and associations.
- The *Planning Cell* oversees the development and implementation of development projects across the MoC, including trade-related programs.

4.9 In 2012, there were 38 staff cadres in the primary trade-related wings and cells (excluding the Planning Cell, where staff are not specifically assigned to trade-related programs), including five additional secretaries (heading each wing/cell) and two joint secretaries (Export and FTA Wings only), with a mix of levels within each wing/cell. While the division and quantity of labor within the MoC is logical, covering the primary mandates necessary to design and implement trade policy, there are a number of issues related to staffing and capacity that impede its effectiveness:

- The MoC must adhere to the current civil service rules and regulations that impose mandatory rotations of staff between ministries below deputy secretary level, leading to a lack of continuity of knowledge and accountability. Staff, including some senior staff, are often recruited from academic disciplines with little or no relevance, creating a weak support structure for routine operations and exerting undue pressure on directors and additional secretaries to fulfill additional tasks. This also necessitates a constant stream of training of officials on trade and commerce at a basic level to maintain the effectiveness of different wings.
- While training is available, mostly through donor and multilateral programs, there are no guidelines for selecting staff for training, leading to a mismatch of skills and jobs. In many cases, prestigious foreign trainings are selected irrespective of whether or not they are aligned with training needs. The benefits of past training have, therefore, been largely unrealized.
- The MoC has ongoing needs for both trade-related and legal skills to review and draft legislation and regulations. But it is dependent on the Ministry of Law to provide assistance and there is generally a lack of qualified lawyers that are familiar with trade law.
- Administrative staff numbers are disproportionately large relative to core technical trade-related staff. Staff of the Administration Wing has survived previous reforms where many technical departments have been abolished or downsized.

4.10 In general, the MoC is constrained by the lack of data and analytical resources in keeping abreast of developments within WTO and FTA negotiations, providing traders and public with trade information, and undertaking basic research on trade issues. The MoC has a weak data management system for securing and disseminating user-friendly trade data. Furthermore, there was only one statistician on its staff, under the FTA Wing in 2012.

4.11 The **Bangladesh Tariff Commission** (BTC) operates as an autonomous institution of the MoC, with the mandate to protect domestic industries from unfair trade practices and provide overall trade policy guidance. The BTC is composed of a chairman and three members, each heading up a functional wing (see annex A, figure 4A.2):

- The *Trade Remedies Wing* is responsible for adjudicating trade remedies, including antidumping, countervailing duties, and safeguard measures, as well as taking action on SPS and TBT measures imposed by trade partners.
- The *Trade Policy Wing* is largely designed as an analytical and advisory unit, covering industrial assistance (subsidies and other measures), sector studies, trade policy modeling, monitoring of prices of essential commodities, and other trade policies.
- The International Cooperation Wing advises on bilateral and multilateral trade agreements.

4.12 Tariff policy, one of the key mandates of the BTC, has been marginalized, with the NBR taking the lead. On multilateral and regional trade negotiations, the BTC plays a key advisory role, primarily due to its current Joint Chief, whose long and active engagement in trade negotiations makes him a key source of knowledge.

4.13 In terms of trade remedies, the rigorous nature of trade remedy investigations and procedures requires a high degree of analytical and legal skills. Currently the BTC has at least four officers with an academic background in economics, but they lack the specific skills for undertaking trade remedy investigations under WTO rules. Moreover, the commission does not have any staff with a legal background to supplement the efforts of the joint chief.

4.14 The **Bangladesh Foreign Trade Institute** was established as a nonprofit research and training institution with the Commerce Minister as the chairman of a 15-member public-private board of directors. The BFTI is currently a shell organization with a large mandate, covering trade research, training and education, and policy advocacy. The current organizational chart calls for two Fellows, one covering Research and one covering Training and Advocacy, with four Research Associates shared between them. At the time of the field mission in April 2012, there was only one research fellow on staff. It is not clear whether there were any research associates currently on staff. Due to the lack of capacity, BFTI engagement in all three mandated areas has been minimal over recent years. Also, due to public sector compensation levels, it is not clear that BFTI is able to recruit staff with the skills necessary to undertake the level of research that the organization is expected to undertake, particularly given that it must compete with nongovernmental organizations (NGOs). NGOs such as the Bangladesh Institute of Development Studies (BIDS), Centre for Policy Dialogue (CPD), and Policy Research Institute (PRI) are able to offer more competitive compensation while also offering a more neutral platform for engaging in policy analysis and advice.

2 Interagency Coordination and Consultation

4.15 In addition to staffing and organizational weaknesses, the trade policy-making framework is weakened by a number of coordination issues (see figure 4.1 for a schematic representation of the process).

2.1 Tariff Policy

4.16 Following liberalization of Bangladesh's exchange rate regime and the gradual dismantling of NTBs, tariff policy has become the principle instrument of trade policy in Bangladesh. While the BTC, an autonomous agency under the MoC, is mandated to *advise* on trade policy through its Trade Policy Wing, including tariffs and other import measures, it does not have any powers outside trade remedies. In practice, the Ministry of Finance (MoF), through the NBR, takes the lead role in tariff setting in Bangladesh.

4.17 The tariff-setting function led by NBR is demonstrably a distinct function in the manner it is being carried out. First, tariff policy is often treated as a subset of *fiscal policy* by the NBR. As a consequence of low domestic revenue mobilization, the orientation of NBR is one of revenue maximization Second, the tariff-setting process gets dominated by the broader budgetary process steered by NBR. There is no forum for consulting on tariff setting as such. However, senior officials at NBR hinted that the "private sector has unfettered access to NBR" and "protecting industries" was one of their key concerns. In the absence of a vibrant and independent counterbalancing force advocating for equity and efficiency, the process of tariff setting is prone to protectionist influences.

4.18 Moreover, in recent years, Bangladesh has demonstrated a growing tendency to set nontransparent "para-tariffs," especially supplementary duties, which are imposed on as much as 17 percent of tariff lines (in FY 2010/11). Supplementary duties, such as excise duties, are expected to be neutral in their application (applied both to domestic and imported goods). However, the NBR Task Force Report 2010 (NBR 2010) recognizes that such supplementary duties are de facto tariffs applied to a number of consumer goods, exacerbating effective protection rates (see chapter 2 on trade policy). The determination of supplementary and regulatory duties is spearheaded by NBR, but as in the case of tariffsetting, the process lacks interagency coordination and transparency.

4.19 Ad hoc supplementary duties are often imposed as a means of circumventing the MoC's role in the administration of contingency trade remedies. The MoC, through the BTC, is legally empowered under Bangladesh Tariff Commission Act of 1992, to administer antidumping investigations. In practice, traders apparently opt to bypass the scrutiny of the BTC, which must adhere to WTO rules, and turn to the NBR to impose additional protective supplementary duties that act as proxy antidumping measures. It is difficult to observe incidences of supplementary duties attributed to circumvented antidumping measures. However, texts from the FY 2011/12 MoF Budget suggest that the imposition of such duties is linked to the protection of domestic industries (as well as revenue generation) (MoF 2011).

2.2 Import Policy

4.20 To regulate imports, MoC routinely formulates an Import Policy Order. The development of the Import Policy is time bound and the process starts almost one year before the expiry of the existing policy, which is deemed sufficient for verification of various protective measures.

4.21 The current Import Policy covers the period 2012-15. It lays out the criteria and conditions for import, including import controls and import bans; import permits, licenses, and conditions of its renewal; standards and specifications set by other agencies—BSTI in the case of TBT and MoA and MoHFW in the case of SPS measures (as elaborated in the next section and chapter 5 on standards); and preshipment inspection. Coordination in the formulation of Import Policy is complicated by a lack of transparency, weak capacity of MoC and key agencies such as BSTI, MoA, and MoHFW; and the lack of analytical rigor in assessing the implications of proposed measures.

4.22 First, the MoC and its agencies spearhead the process the formulation and implementation of Import Policy through various consultative committees, and coordination is maintained through meetings at the interministerial committee and cabinet subcommittee level (see box 4.1). Although a range of private sector stakeholders are consulted, the process is dominated by the large trade associations,

including the Bangladesh Garment Manufacturers and Exporters Association (BGMEA) and the Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA), as well as the chambers of commerce and industry, membership in which is compulsory for most industries. Other nongovernmental stakeholders (for example, representatives of consumer interests) are missing from the process.

Box 4.1: Import Policy Formulation

The Import Policy formulation process begins with the MoC and the Office of the Chief Controller of Imports & Exports inviting proposals from stakeholders, including from the private sector through the chambers of commerce and industry. Issues may also be raised autonomously by stakeholders (both public and private) seeking amendments to the existing policy as part of the budgetary process.

The agenda and proposals are subsequently tabled (including new measures on import bans) at a Consultative Committee chaired by the Minister of Commerce and at times jointly with the president of the Federation of Bangladesh Chambers of Commerce and Industry (FBCCI). The committee generally consists of the FBCCI, Metropolitan Chamber of Commerce and Industry (MCCI), Dhaka Chamber of Commerce and Industry (DCCI), Bangladesh Chamber of Commerce and Industry (BCCI), Malaysia-Bangladesh Chamber of Commerce and Industry (BCCI), Malaysia-Bangladesh Chamber of Commerce and Industry (BCCI), Malaysia-Bangladesh Chamber of Commerce and Industry (BCCI), Consultation with issue-specific institutions takes place at a subcommittee level, such as on coal standards. MoC consults and receives inputs from BSTI (although their effectiveness remains unclear due to BSTI's capacity constraints).

The decisions reached are subsequently tabled at a Cabinet Sub-committee on Economic Affairs, which is headed by the Finance Minister and composed of ministers of trade-related ministries. Before being submitted to the cabinet for approval, the policy is vetted through the Law Ministry.

4.23 Second, while specialized agencies such as BSTI, MoA, and MoHFW (on standards), or Bangladesh Bank (on services), are expected to address any technical requirements, the NBR approves bans and import restrictions on the basis of revenue concerns. MoC has the authority to reject proposals not consistent with its WTO commitments and other applicable rules. In case of disagreement, the issue is resolved through discussions and consultations. Issuing ministries or organizations have an opportunity to propose alternatives and, if acceptable, particularly in terms international rules, MoC accepts the alternate proposal. While the MoC has not provided information regarding the frequency with which it rejects measures proposed by others, there remains an overall lack of capacity to fully assess the regulatory or economic impact, outside of whether the measures are aligned with Bangladesh's commitments.

4.24 Finally, while the Import Policy is explicit in terms of the conditions for the removal of restrictions and bans, there are no objective criteria for their imposition (for example, what qualifies as injury to domestic industries). From an institutional standpoint, the BTC is mandated with recommending and monitoring protective import bans and restrictions. The legislation imposes a high burden on the commission. For example, once a restriction or ban is adjudicated in favor of an industry, the BTC is required to "strictly" monitor production of that industrial unit. A trader who is aggrieved by any decision regarding a ban or restriction can refer his representation to the BTC, which is responsible for examining the claim and making its recommendations to the MoC. Interviews point to a lack of sufficient technical capacity within the BTC to effectively analyze and monitor the impact of bans and restrictions. This lack of capacity, combined with opportunities for rent seeking, has created a framework that is potentially subject to abuse and often leads to the imposition of protective orders that are not adequately justified. A recent analysis of nontariff measures by the World Bank revealed that traditional regulatory instruments such as quantitative restrictions (including quotas, import bans, and non-automatic licensing) are on the decline in Bangladesh, but it has detected increasing use of import restrictions on health, environment, security, and religious grounds. This puts a spotlight on the formulation and efficacy of Import Policy to not only comply with WTO norms but to act as an instrument guiding trade development.





2.3 Other Import-Related Measures: Technical Barriers to Trade and Sanitary and Phytosanitary Standards

4.25 As discussed above, TBT and SPS measures, while enforced through the Import Policy, are set through regulations and other measures by the responsible line ministries and their agencies.

4.26 The BSTI, an adjunct of the Industrial Ministry, is the main body mandated to formulate national technical standards for all products (except pharmaceutical products); enforce compliance with standards; and certify the quality of products for local consumption, export, or import. The BSTI Council, the highest decision-making organ of the institution, consists of representatives from different ministries, business chambers, scientific organizations, and universities. It has an internal committee on WTO affairs and is also Bangladesh's WTO TBT national enquiry point (WTO 2012) and participates in the working groups on WTO agreements in the Ministry of Industries and Ministry of Agriculture. It has yet to receive a single enquiry from another WTO member.

4.27 Development of SPS consist of three areas: food safety, plant health, and animal health. Given the different technical issues, like other countries, it is not uncommon for multiple government agencies to engage in setting, implementing, and managing SPS policy. For example:

- **Food safety** is under the domain of the Ministry of Health. Though food safety is not highly prioritized, impacts on trade largely take place through the actions of the Department of Fisheries and the BSTI.
- **Plant health** is under the Plant Protection Wing, Ministry of Agriculture. A new Plant Quarantine Act was passed in 2011. However, as this new Act greatly expands the scope of plant health policy is yet to be fully implemented and the Plant Protection Wing continues to follow the old Act.¹
- Animal health is under the Department of Livestock, Ministry of Fisheries and Livestock. It is believed activity and capacity in this field is very low (Jensen, 2012).
- **Fisheries quality,** including issues of food safety and animal health for fishery products, fall under the Department of Fisheries, Ministry of Fisheries and Livestock. The separation of fishery issues took place to satisfy stringent EU and U.S. demands in the very important shrimp sector.

4.28 For both SPS and TBT, the current consultative process in developing standards is weak. Although various consultative committees are in place, they are largely dominated by the BSTI (for TBT) and "private sector" representatives are often drawn from state-owned enterprises. A more open and transparent process would facilitate ongoing compliance with the government's WTO commitments and facilitate trade.

2.4 Export Policy and Industrial Policy

4.29 The government's export strategy is managed through an Export Policy (2012-15), formulated by the MoC. The objective of the Export Policy is to enable the private sector to increase and diversify exports, stimulate higher value-added exports, and increase productivity through a series of series of incentives and other support measures (see annex A, box 4A.1). Unlike the Import Policy Order, the Export Policy is an enunciation of desired programs without a legal foundation. Its implementation is an NBR prerogative, subject to revenue constraints. The policy, nevertheless, is of significance as it

¹ As of 2012, phytosanitary certification is required for all imported plants and plant products. There are 26 quarantine stations at the border: 20 at land borders, 3 in airports, 2 in sea ports, and 1 in a river port. Each quarantine station has a staff of 6–8 people; Chittagong has 14 staff members. About 190 people in total work in quarantine.

constitutes the government's export mandate for trade development and growth, which the NBR and other institutions tend to heed.

4.30 The formulation of the Export Policy mimics the Import Policy in terms of the interministerial coordination and the stakeholder consultation process (see box 4.2). The Export Promotion Bureau (EPB) spearheads the formulation and review of the Export Policy (including export incentives and facilities). The mission meeting at the EPB and feedback from donors revealed weak capacity at EPB in all aspects of its core functions, including the Policy and Planning Division, which provides advocacy efforts in policy formulation, country image building, and export support services. Key decisions on Export Policy rest mainly with the additional secretary, who appears to be the principal source of institutional memory; at the deputy secretary level, there appears to be the same skills mismatch experienced by the MoC. Given inadequate analytical capacity at the EPB, it is highly unlikely the proposals receive adequate scrutiny, making the Export Policy susceptible to an even higher degree of industry lobbying efforts than Import Policy. The vetting process therefore relies heavily on the NBR's (unknown) internal evaluation criteria and therefore not transparent.

Box 4.2: Export Policy Formulation

The consultative mechanism for the Export Policy follows the proposed initiatives of the Business Promotion Council, led by a consultative committee chaired by the MoC. The consultative committee consists of public and private stakeholders from FBCCI, MCCI, BGMEA, BKMEA, and BEPZA; other trade associations for goods such as leather, jute, processed agricultural goods; the Bangladesh Bank (for regulations, especially foreign currency); insurance associations; raw material importers; and the key ministries, including the MoF (NBR), Ministry of Agriculture, and Ministry of Textile and Jute, Ministry of Environment, and think tanks such as BFTI and CPD. While the cabinet approves the final draft of the Export Policy, the MoF determines the rates and amounts of subsidies.

4.31 Further incentives are provided through the Industrial Policy formulated by Ministry of Industries to support private sector industrial growth. Despite a common orientation toward export growth, there is no coherent vision guiding implementation of an export strategy in Bangladesh. The recent EU-funded Comprehensive Trade Strategy asserts that the selection criteria for identification of priority sectors under the Export Policy and the Industrial Policy are vague. Moreover, performance of the priority sectors that receive incentives is not adequately monitored, partly owing to a lack of capacity and resources.

4.32 Equally important, there is little coherence between the Import Policy (which promotes the protection of import-substituting domestic market-oriented and labor-intensive industries) and export incentives as propagated through the Export Policy and Industrial Policy. This has created a highly distorted incentive environment in which selected domestic and export sectors are subsidized through high effective rates of protection. The disconnected policy-making processes and policies that resulted also fail to take into account the countervailing effect that import restrictions have on exports (see chapter 2 on trade policy).

2.5 Multilateral, Regional, and Bilateral Trade Agreements

4.33 In Bangladesh, the MoC is the focal point for evaluation and negotiation of, and compliance with, multilateral, regional, bilateral trade agreements, including WTO agreements. The MOC's FTA wing suffers from the same civil service appointment and rotation policy that prevents "institutional memory" and the efficient functioning (box 4.3). At an individual level, the joint chief of the BTC appears to be a key official contributing to negotiations. His long tenure (an exception to the civil service rotation policy) and acquired knowledge on market access and NTBs have made him an indispensable source for preparations and negotiations on bilateral trade and FTAs.

Box 4.3: The Ministry of Commerce's FTA Wing

The FTA Wing comprises five deputy secretaries and three senior assistant secretary/assistant secretaries who report to the additional secretary. Administrative functions are assigned to deputy secretarys based on multilateral, regional, or bilateral FTAs. For example:

- South Asian Free Trade Area (SAFTA), Asia-Pacific Trade Agreement (APTA), and Agreement on SAARC preferential trading arrangement (SAAPTA) issues are under Deputy Secretary (FTA-1).
- UNCTAD, D-8, and the Framework Agreement on Trade Preferential System among the OIC Member States (TPS-OIC) are dealt with by Deputy Secretary (FTA-2).
- Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), Indian Ocean Rim Association for Regional Cooperation (IOR-ARC), Transit, EU, and Pakistan are dealt with by Deputy Secretary (FTA-3 Branch).
- Bhutan, Myanmar, Sri Lanka, and Rules of Origin are dealt with by Trade Consultant (Deputy Secretary).
- India is dealt with by Deputy Secretary (FTA-1 Branch).

All these deputy secretaries report to the additional/joint secretary (FTA); the additional secretary reports to the MoC secretary, who ultimately reports to Minister of Commerce.

4.34 Preparations for negotiations on SAFTA, APTA, and other agreements are made through an interministerial committee established for each agreement and chaired by the MoC leadership, through the additional secretary and joint secretary, both of whom are seasoned negotiators with a long history of experience. The committees consist of public and private institutions, with a mechanism for receiving inputs from stakeholders in preparations for negotiations (see annex A, box 4A.2).

4.35 Preparations for regional trade negotiations follow a standard norm of coordination between government bodies and the private sector. However, there is a lack of continuity in the consultative process. According to senior officials, stakeholder configuration (both public and private sector) is not "permanent" and is subject to change during the course of the interagency coordination process, partly owing to prolonged regional trade negotiations. Furthermore, the MoC and committees seem to have little ability to generate interest in the private sector. Leading commercial enterprises interviewed were not aware of the existence of the consultative process; nor have they made any inquiries on the "offer list" or "market access" in recent negotiations under SAFTA or APTA. In contrast, in countries such as India, Pakistan, and Sri Lanka, industry organizations collectively and individually play a key role in shaping the government agenda through their chambers or associations on issues related to market access (or on protection through negative lists). Moreover, despite the large number of sectors affected by negotiations, there is no mechanism in place for broader public consultation with affected parties, which include service industries, labor, consumers, and households.

4.36 The agenda for regional and bilateral trade negotiations is set through intergovernmental negotiations (see box 4.4). The MoC routinely consults private think tanks, especially CPD, due to its leading role in policy-oriented regional trade. MoC also draws on its affiliations to the South Asian research network, its relatively active engagement in regional workshops and seminars, and research and articles on regional trade.

Box 4.4: Interagency Coordination on Trade Agreements

Initiated by the MoC, interministerial committees on trade negotiations are usually agreement-specific. The Ministry of Foreign Affairs spearheads the diplomatic affairs in close collaboration with the MoC. Other key government members of the committee include the Ministry of Industries, NBR, Ministry of Law and Parliamentary Affairs, Ministry of Agriculture, Ministry of Home Affairs, BTC, EPB, Office of the Chief Controller of Imports and Exports, and the BFTI. The private sector is represented by FBCCI, MCCI, and DCCI. Policy research institutes such as the Centre for Policy Dialogue (CPD) and the Policy Research Institute are also invited to sit on interministerial committees.

4.37 The head of the FTA Wing of the MoC (Additional Secretary/Joint Secretary FTA) is typically considered the highest-ranking authority in trade negotiations and is also the Head for Trade Negotiations Committees. Deputy Secretaries from the FTA wings have also served as the negotiating authority. Preparations for negotiations are supported by the International Cooperation Wing of the BTC and the BFTI. They provide the MoC with independent analysis, research, information, and recommendations on FTAs. As noted above, their capacity to do so, in practice, remains limited.

2.6 Stakeholder Consultation

4.38 As indicated in the preceding sections, stakeholder consultation on trade policy is largely dominated by the large chambers and associations. FBCCI, DCCI, MCCI, and key trade associations such as BGMEA, BKMGA, the Jute and Textile Association, and the Leather Producers Association are all engaged as standing committee members at the preliminary stages of the policy-making process. Chambers and associations routinely engage the MoC, Ministry of Industries, EPB, and the NBR on regulatory or other business-related issues. FBCCI, the apex body of all chambers, plays a pivotal role from the policy initiation stage until the draft policy is submitted to cabinet for approval. At the final vetting stages, FBCCI is the only private sector representative consulted.

4.39 The lack of transparent and inclusive structures for consultation can be broadly highlighted from two perspectives. First, the FBCCI secretariat, with its small research staff (currently comprising two staff with MBAs, two with BAs, and the support of a relatively senior associate in economics) and limited budget,² is expected to make an effective contribution to the 50 or so different public sector forums that it is engaged in every year. Given the FBCCI's prominence in consultative committees and standing committees on key sectors of trade, a lack of research capacity needed to support private sector interests has undermined the effectiveness of its inputs.

4.40 Second, often the interests of only a handful of selected sectors are represented. The BGMEA, BKMEA, Jute and Textile Association, and Leather Producers Association together exert undue influence on trade policy. This enables them to benefit from the most favorable incentive regime, which creates sizable bias across sectors. Small traders and producers are often marginalized because they have few resources to analyze and respond to such issues in a timely manner. Moreover, few, if any, representatives from other sectors of the economy that will be affected by trade policy are consulted, including consumers, labor, and service industries. This contributes to a policy-making environment that is heavily skewed toward the large, established industries, which can lead to policies that are not in the best interests of Bangladesh. This is partly a historical legacy of the import-substitution model that characterizes many developing countries, whereby businesses in only a few sectors hold sway and the interests of the broader constituency of consumers, labor, and civil society are marginalized.

² European Commission Staff Working Paper (2011) Vol. 1, pp. 12

3 Toward a New Trade Policy Framework

4.41 The preceding discussion highlighted a number of weaknesses in the existing institutional framework for trade policy in Bangladesh. These have contributed to the fragmented trade policy framework and conflicting roles and responsibilities. The main issues are summarized below:

- Policy-making is carried out through a number of government institutions in a piecemeal fashion, blurring the lines of responsibility.
- Stakeholder consultation is weak in terms transparency and accountability, as the policy-making process is largely captured by special interests.
- An active dialogue with representatives of civil society such as labor, households, and consumers is either nascent or absent in Bangladesh.
- Both public and private institutions that are intimately engaged in trade policy formulation and implementation lack the capacity to analyze and respond to such issues in a timely manner.

4.42 A more cohesive trade policy framework would recognize that trade policies encompass a much broader agenda, including both the direct and indirect ways in which trade and trade-related policies affect welfare. This requires recognition of the need for consensus on national interests and the role of trade in meeting the broad economic objectives of growth, exports, and poverty reduction.

4.43 Trade policy formulation is not a one-off event but an iterative process that requires effective interagency coordination and stakeholder consultation, backed by data and analysis throughout the policy-making lifecycle. No single correct structure for trade policy *initiation, formulation, implementation,* and *evaluation* framework exists; they vary according to the existing governance structures, legal frameworks, and institutional proficiencies. Improving the quality of trade policy formulation in Bangladesh requires an individualized and more systematized approach that encompasses complementary elements that work together throughout the policy-making lifecycle (see figure 4.2).

4.44 The starting point for creating a more cohesive policy-making process starts with consensus on a national vision and strategic direction of trade policy reform that is aligned with Bangladesh's broader economic development objectives as laid out in Vision 2021 and the Sixth Five-Year Plan. The objective of such an agenda is to create a unified framework for the development of trade-related policies that balances the interests of all key stakeholders (including the often-forgotten consumer), is linked with Bangladesh's international commitments and helps guide future positions on international negotiations, and has a clear monitoring and implementation plan that clarifies roles and responsibilities. This DTIS, together with the EU-supported Comprehensive Trade Policy, can provide the analytical foundation and the core linkages that need to keep in mind for such a reform plan



Figure 4.2: Trade Policy Lifecycle

4.45 Addressing the lack of synergies and inefficiencies in Bangladesh's trade policy formulation system would entail the following actions:

- More effective interagency coordination. Coordination among the numerous public sector actors engaged in trade policy is critical for realizing the benefits of Bangladesh's participation in global trade. Effective coordination mechanisms need to be adaptable to the evolving demands of the global trading environment. These demands include the ongoing fiscal and financial crisis, rebalancing after the crisis, and the expected shifts of global growth towards a more multipolar world. The shifting global environment will make necessary the regular reassessment of the scope and priorities of Bangladesh's trade policies. It is recommended that all trade policies, including tariffs, import taxes, and standards, should be vetted through a uniform, standardized process.
- **Inclusive and transparent stakeholder consultation.** Without broader policy consultation with economic and social partners, interagency coordination alone cannot achieve national consensus on trade policy objectives. Interagency coordination and stakeholder consultation processes are complementary and need to be conducted systematically across all stages of the policy-making process.
- Evidence-based research and analysis. Coordination and consultation can only be effective if built on a sound foundation of economic research and analysis. This foundation will help stakeholders understand the potential ex ante economic impacts of trade policy reforms and the ex post impacts on the economy.

4.46 **The above principles are well illustrated in the case of trade negotiations**, which increasingly encompass a broad spectrum of regulatory issues beyond tariff concessions. Interagency coordination and stakeholder consultations are critical in the early stages to identify interests and options and the development of a negotiating position. Ex ante partial and general equilibrium analyses can provide the basis for quantifying the potential impact of policies on revenues, trade flows, and sector output and employment. Stakeholder consultations in the early stages can build support at home for identifying priority demands for increased market access. Although one or two agencies take the lead during negotiations, open channels to other Ministries and agencies are critical to rapidly reach consensus on

non-tariff related provisions. Post-negotiations, implementation often requires ongoing inter-agency coordination to ensure compliance with the provisions of the agreement, continued awareness building among stakeholders, especially in the private sector, to promote diversification into the new market, as well as *ex ante* monitoring and evaluation of economic outcomes to inform future rounds of negotiation.

4.47 While there is no one-size-fits-all approach to organizing trade institutions, international experience provides a number of good practices that could be incorporated into Bangladesh's existing framework to improve the quality of trade policy-making, through a systematic approach to make interagency coordination more effective, increase the transparency and scope of stakeholder consultation, and strengthen the quality of research and analysis required to support the policy-making process. Figure 4.3 provides an illustrative approach to organizing Bangladesh's trade-related institutions and stakeholders to initiate, formulate, implement, and monitor trade policy reforms.

4.48 Any redesign of Bangladesh's institutional structure for trade should be designed to build on existing capacities and institutions, with a focus on strengthening linkages within Government and between the public sector, private sector, research and academic community, and other stakeholders, such as labor, consumers, and others.



Figure 4.3: Toward a New Institutional Framework in Bangladesh

4.49 The following sections provide a detailed assessment of options, including a discussion of international practices, for the main components of a more systematic trade policy framework. The options include improved mechanisms for interagency coordination and more effective and transparent stakeholder consultation. In addition, better access to robust research and analysis will support policy making and help build the capacity of public and private institutions to improve the coherence of trade policy.

3.1 Improving Interagency Coordination

4.50 While a number of mechanisms are in place to support interagency coordination in Bangladesh, their fragmented nature has contributed to fragmented trade policies. Effective trade policy coordination is based on achieving three important targets: (i) integrating Bangladesh's domestic trade policies with its

numerous existing and future international trade agreements into a coherent trade and development strategy; (ii) eliminating contradictions in trade policies, such as the Import Policy and Export Policy; and (iii) streamlining the approaches of various government institutions engaged in trade policy formulation and implementation. The ministries of commerce, finance, agriculture, health, and industries and their respective agencies must work together to ensure efficient policy making.

While there is no one-size-fits-all approach to interagency coordination, two broad typologies of coordination are observed. They are not necessarily mutually exclusive and elements of each may be present in a single country:

- Strong, centralized executive-level agency, often outside the ministerial structure. Given that trade policy has broad impacts beyond the traded sectors of the economy—including, for example, labor, households, and the environment—some countries have established agencies that are not bound to the narrow interests of a single ministry. An executive-level agency offers a number of advantages in terms of strengthening the trade policy framework. But the most valuable feature is the autonomy given to the lead agency, providing an arms-length relationship from the vested interests of a single ministry. In the United States, for example, the U.S. Trade Representative is a cabinet-level agency reporting directly to the U.S. president. The agency is responsible for setting the policy agenda, although it coordinates with line agencies through a series of committees.
- High-level interministerial committee with formal mandate. Where no centralized institution exists, many countries rely on interagency committees to formulate, rationalize, and monitor the implementation of trade policies. Unlike Bangladesh, many countries have a multitiered network of committees that ensures that interactions take place at the right level, as some but not all decisions require minister-level engagement. This tiered approach also imposes a greater level of discipline and accountability in the policy-making process and reduces the potential for rentseeking behavior, since certain policy changes can be mandated for approval at a higher level. In Indonesia, for example, a National Team for Increasing Exports and Investment was established in 2003, with the president as chair, to formulate trade and investment policies. In 2005, an interagency Indonesian National Trade Negotiation Team was also established to improve Indonesian participation in international trade negotiations. In the United States, the U.S. Trade Representative relies on a multitier, multichannel approach to interagency coordination. An interagency Trade Policy Review Group is chaired by the Deputy Trade Representative and brings together undersecretary-level officials from over 20 agencies to consult on the trade agenda and to coordinate implementation. The latter role is largely delegated to a Trade Policy Staff Committee comprised of senior officials from the same set of agencies to coordinate implementation, which is supported by some 80 different subcommittees that work on different policy issues.

4.51 Establishing a new trade agency in Bangladesh, while potentially advantageous, would be a long and complex process, in terms of parliamentary approvals. More expedient would be a reworking of the existing structure of trade-related committees under the MoC as the focal point, drawing on and adapting the experience of other countries. Reconstituting and embedding the existing technical committees in a multitiered system, with clearly defined mandates in terms of decision authorities at each tier and defined roles and responsibilities of each agency, can instill greater discipline and accountability for policy decisions.

4.52 Though not significantly different from the current setup, such a structure would provide a more systematic approach that, in combination with a more formal vetting process, backed by consultation and analysis, would lead to greater discipline and accountability. A more structured system of coordination would also help reduce the incentives for rent-seeking behavior that are present in the current system. It is recommended that a new, streamlined framework be applied across the full spectrum of trade policy issues, including tariffs and taxes, which are largely outside the existing coordination/consultation process

where no formal committee currently exists to balance the interests between MoC, NBR, and others. Similarly, in the case of standards, a more structured vetting process through the committee framework, tied to transparent consultation and research and analysis, can better ensure that TBTs and SPS measures meet the needs of the market and are in compliance with the spirit of Bangladesh's WTO and other international commitments.

3.2 Creating a Transparent and Inclusive Consultative Process

4.53 Even if the trade policy is guided by a clear agenda for trade development, poor consultative mechanisms can dampen the outcomes of policies. Often, there are fixed costs related to trade, and they disproportionately affect small and medium enterprises (SMEs), the poor, and rural and urban farmers, prohibiting their participation in trade and limiting inclusiveness. Furthermore, it can be argued that structures that allow broader participation by public and private sector stakeholders are more likely to be considered legitimate, and will therefore are likely to be more sustainable and effective. While the existing coordinating committees have engaged the private sector to some degree at the technical level, the diagnostic points to the absence of engagement at a higher level of decision making to define the vision and direction of trade policy, as well as the exclusion of other stakeholders from the policy-making process. The following discussion offers options available both using existing institutions that could be augmented and other mechanisms that could be evolved over time.

3.2.1 Potential Role of BUILD in Consultative Process

4.54 The Business Initiative Leading Development (BUILD) is a joint initiative of the Dhaka Chamber of Commerce and Industry (DCCI), the Metropolitan Chamber of Commerce and Industry (MCCI) and the SME Foundation as a platform for the government and the private sector through which both sides can work together and address the key constraints that are impeding the growth of the private sector. BUILD works through four thematic Working Committees - Financial Sector Development, SME Development, Trade and Investment, and Taxation. BUILD can potentially be expanded to improve stakeholder consultation on trade policy, particularly in areas that are related to the regulatory and procedural aspects, such as those covered by the Import Policy Order. By bringing in SME representation and creating an effective partnership with think-tanks, academia and chambers and maintaining coordination and continuity between public and private sector understanding for better reforms, the engagement of BUILD can tilt the 'playing field' that is skewed towards established and large scale enterprises that have captured the trade policy-making process. The more open process will also improve transparency, reducing the incidence rent-seeking behavior. BUILD will be able to address, on a priority basis, the most punitive of the regulatory issues that disproportionately impact SMEs, such as licensing, customs and other traderelated transactions costs.

3.2.2 Building Mechanisms for Broader Consultation

4.55 Both BUILD and the existing committees can be effective mechanisms for engaging broader private sector consultation, however their focus is currently limited to the *tactical* rather than *strategic* level of policy-making and their participation, outside Government, is limited to the private sector. The following provides options and recommendations for creating a broader framework for stakeholder consultation that is both more strategic in nature and broader in terms of participation.

Role of Competitiveness Councils in Trade Policy Strategy

4.56 Many countries have instituted Competitiveness Councils or similar advisory bodies to provide Government with strategic inputs into developing policies to support a competitive private sector. Competitiveness Councils and Advisory Boards encompass "behind the border" issues with a mandate for greater regulatory scrutiny. They also act as a "sounding-board" for major trade policy initiatives (Import, Export and Industrial) which elude the existing institutional framework in Bangladesh. The merit of Competitiveness Councils is not just its broader scope—such Councils are typically comprised of prominent members of the business and research community and have access to the highest levels of decision-making apparatus in a country, typically the Prime Minister's or Presidential Office. For example, in the Philippines, the National Competitiveness Council was formed by executive decree in 2006 as a public-private Task Force to address the improvement of the country's competitiveness. The council is co-chaired by Trade and Industry Secretary (Minister-level post) and a prominent private sector representative. Its Working Groups cover a broad range of private sector competitiveness issues, including trade and customs, business licensing, anti-corruption, among others. The NCC maintains strong links to academia, which plays an important role in providing policy research and analysis to back the policy agenda. Similarly, in Indonesia, the Export Expansion and Investment Promotion (PEPI) was established to formulate policies and evaluate strategic issues related to export and investment promotion with a mandate to engage government in regulatory issues at the policy *formulation* stage. PEPI has been credited to remarkable recent successes in preventing some the punitive regulations that are in violation of WTO obligations.

4.57 The modus of operation of such Councils includes both sector and functional Working Groups, with; some permanent and others *ad hoc*, as may be deemed necessary. One option in Bangladesh may be to develop Working Groups to discuss draft decisions and regulations under a Council structure to collect more detailed and precise information on specific policies and regulations not covered by BUILD. Working groups can also ensure deeper participation from a wider private sector.

4.58 There does not appear to be single "best" approach to Council formation of this type. However, successful Competitiveness Councils appear to share a number of characteristics that should be considered in Bangladesh:

- Councils are of relatively small size (15-20 individuals at most) and include representatives from the public sector, the private sector, academia, and labor to guarantee multiple perspectives.
- Councils should have a bi-partisan, multi-partisan, or non-partisan composition. This helps build consensus in the country around the goal of competitiveness while also allowing it to survive a change of government.
- Councils should be recognized by the government, enabling the council to exert real influence over government policy. This does not always necessitate that government officials formally sit on the council. In Ireland, for example, links between the council and the government come via direct meetings between the council Chair and the Prime Minister, while senior civil servants attend council meetings and participate in deliberations.

Improve Transparency through Broader Stakeholder Consultation

4.59 Establishing an active dialogue with the private sector and representatives of civil society such as labor unions, consumer associations, vulnerable and disadvantaged populations (gender, youth, rural), and academia and research institutes is essential to generate support needed for reform and can also be an expedient mechanism for exposing excessive economic rent-seeking behavior of businesses and align it with other stakeholder interests.

4.60 In Bangladesh, the existing Consultative Committees are not designed for a broader stakeholder regime, let alone a broad private sector representation. There is, therefore, a need to develop new mechanisms that can create a more transparent and participatory process, in addition to those described above, which are focused largely on engaging the private sector. An effort should be made to include academia and think tanks to inject an analytical dimension to debates and discussions providing a balanced outcome to proceedings. Participation of academia and think tanks in common forums further serve the inoculator position identifying 'beneficiaries' and impact of 'consumers' to help dissuade common misunderstanding broader groups with competing interests that would otherwise find no common ground.

4.61 While the MoC has a key role to play, effective consultation should be the responsibility of all trade-related agencies. Effective consultation requires the development of systematic and structured mechanisms to engage stakeholders throughout the policy-making lifecycle, including more structured and standardized methods of work, such as channels of consultation through open hearings on key policy matters, using the Gazette, roundtables and forums, as well as public access to deliberations of the interministerial committees.³ Consultation should be based on the following principles:

- **Timely information and agenda-setting.** Meeting dates and agendas should be available to participants well in advance. Short reports on meetings should also be produced and distributed as soon as possible.
- **Broad representation.** The widest possible range of interest groups from the private sector and civil society should be encouraged to participate. Participation by groups that lack financial resources can be funded if doing so ensures broad representation.
- **Transparency of participation.** Organizations intending to participate in national trade dialogue meetings should register to do so and a database of all participating organizations should be maintained with standardized practices for consultation. Such a policy will require investment in new procedures and staff training in how to consult and how to use information from consultations. Some developed countries have invested in Web-based platforms for dialogue and dissemination and developing countries are beginning to do the same. For example, the business sector in Jamaica has developed a website called "The Briefing Room" which provides information to private sector stakeholders on external trade negotiations. Operationalizing this process require a public outreach plan and staff training in how to consult and how to use information from consultations.

4.62 If needed, the Government of Bangladesh should consider the development and implementation of a mandatory consultation policy, based on international practice and e-Government tools that lays out goals, standard methods, and an implementation plan.

3.3 Enhancing Analytical Capability to Support Trade Policy

Measuring and exposing the economy-wide costs of trade barriers has been both crucial and unique to successful reformers of less developed countries (in Latin America, East Asia, and Eastern Europe) that have made great strides in improving the quality of trade policy decision-making, largely on the back of unilateral reforms. Bangladesh has in most part enjoyed preferential status in key markets but has largely ignored potential cost of protecting the domestic market—costs that have significant welfare implications that potentially thwart the emergence of new and more dynamic products and services.

4.63 The current structure of economic and regulatory impact analysis supporting government trade policy formation is weak (EU, 2010). A major challenge confronting Bangladesh is the need for an objective, independent, rigorous and authoritative policy *evaluation* mechanism that provides the impact of proposed reforms which can otherwise persuade policy-makers of the merits of trade liberalization. The following offers two complementary paths to strengthening the capacity for trade-related research and analysis—the first relies on existing institutions, while the second is a more robust platform, modeled on a tried and tested mechanism adopted by Australia.

³ The main formal consultative committees on trade-related issues are the National Committee on Exports, Consultative Committees, one each on imports and exports, and the High-powered Committee on WTO issues. Among those committees, some are of permanent nature and some are issue-specific (and exists only up to resolution of the issue).

3.3.1 Building on Existing Institutions

Strengthening Linkages with Think Tanks and Academia

4.64 In Bangladesh, the knowledge pool and expertise capable of comprehending demands of the emerging trade agenda and the competing paradigms for trade development is sparse and difficult to attract to the public sector due to compensation and poor image of public institutes. Eminent economists with competence in Bangladesh are either attached to academic institutes, international organizations or leading think tanks, such as CPD, PRI or BIDS. They have often obliged the government with research and advocacy, either formally, such as through BIDS' statutory role under Ministry of Planning and the CPD's role in the EU-funded work to develop a 'comprehensive trade policy', or through the various Consultative Committees.

4.65 Mobilizing key economists from Bangladesh's existing think tanks and policy institutes more formally to support policy-making throughout the life cycle would be beneficial to bring to bear the analytical and research capacity of these institutes to support policy-making, to undertake *ex ante* studies of options, e.g. for trade negotiations, regulatory impact assessments (e.g. for licensing and standards), and *ex post* measurement of impacts of trade policy reforms. The PCC already has established linkages with the various think tanks and institutes—creating a funding mechanism would allow trade related ministries and agencies to commission studies on an as-needed basis.

Building In-House Capacity within MoC

4.66 The above needs to be complemented by greater capacity within the government to commission and absorb the results of the research and analysis. As the lead trade policy institution, there is an urgent need to ensure that the MoC has capacity, at a minimum, to undertake this role, as well as some basic research and analysis (such as trade trends and tracking various trade indicators using the World Integrated Trade Solution and other tools). A dedicated Economic Advisor to the Ministry should be considered to provide ongoing advice to the minister on trade policy matters, though donor support may be required to attract eminent economists and overcome salary constraints. The advisor could also play a key role in supporting the development of an in-house unit that would undertake basic research and manage and digest external research on behalf of the MoC.

Leveraging the PFF Framework

4.67 Following the model of India's National Institute of Public Finance and Policy (NIPFP), the Public Finance Foundation (PFF) was set up in Bangladesh with a mandate of promoting research and policy guidance on public finance, including fiscal policy. The PFF is expected to act as an advisory body for effective public finance management, providing consultative services, and liaising with academic institutes and development partners contributing and shaping public economics agenda in Bangladesh. Thus far, progress has been limited to helping design courses and guidelines for PFM and providing a training course.

4.68 Evidence suggests that many countries are facing the need for specialized capacity for providing an analytical basis for influential fiscal policy and public economics through institutions like the NIPFP. These institutions have permanent structures led by professional economists, and are typically outside the civil service—both to improve the recruitment and retention of trained economists and to provide for greater autonomy from both the government and private sector. While the PFF has the potential to play an important role, as it is currently structured, as an extended arm of the Finance Division of the MoF, it lacks the degree of desired independence from the NBR. A more desirable structure would provide the PFF with a degree of autonomy, similar to that of India's NIPFP (see Annex A, Box 4A.3). With appropriate resources and autonomy, PFF could fulfill a large void in public finance–related research and advocacy as well as the analytical rigor that is missing in currently policy deliberations. **4.69** The PFF framework, if successfully developed, has the potential to play a critical role in supporting trade policy formulation in areas directly linked to PFM. These include both ex ante and ex post analyses of the economic, sector, and financial impacts of policy changes. Such policies might include changes to trade-related taxes, including tariffs, supplementary duties, and other trade taxes, as well as other tax policies with direct or indirect impacts on government revenues and/or expenditures, including incentives, subsidies, grants, and other concessions to the private sector.

Establishing a Productivity Commission

4.70 A well-defined, funded, and staffed PFF could be an effective in resolving key frictions in trade and tax policy tariff, import taxes (supplementary duties), and multiple incentives. Existing think tanks are well-geared toward providing modeling work on tariff-related policy analysis related to unilateral trade liberalization as well as trade agreements. A clear understanding of the impacts of the remaining trade agenda—NTBs, standards (SPS/TBT), licensing requirements, non-recognition of foreign qualifications or accreditation, local presence or ownership requirements, intellectual property rights, and so forth—will be critical to developing a coherent trade policy agenda in Bangladesh.

4.71 New models addressing the broader incentive and regulatory environment linking national development strategies to trade have proliferated in recent years. For example, the role played by the Productivity Commission (PC) of Australia provides a profound lesson for an independent source of analysis for development-oriented trade policy for Bangladesh and developing countries elsewhere (see annex A, box 4A.4). The PC is set up as an independent principal evaluation and advisory body on microeconomic policy and regulation. Its rigorous and authoritative quantitative estimates of the costs of trade barriers and other forms of government assistance to industries to consumers and to the economy as a whole has helped persuade policy makers of the merits of trade liberalization. Transparency, independence, and the evaluation of economy-wide effects of policies have become three fundamental principles of the PC—all essential attributes that are currently missing from current policy-making apparatus in Bangladesh.

4.72 The platform for a PC-type institution may be germinated in Bangladesh by starting a dialogue with the key stakeholders willing to champion the cause. In the early stages, it can take the form of an advisory board, commissioning independent studies through eminent local economists within academia or think tanks, to provide strategic advice on trade policy. This would be a complement to a competitive council type of body, and with the support of an enhanced consultation framework, the advisory board would offer insights on trade and investment issues of relevance to regulatory reform and/or trade negotiations.

4 Building Institutional Capacity

4.73 Improved mechanisms for policy coordination and consultation must be complemented by improved skills and capacities within the key government institutions. The resource needs to implement a reasonably comprehensive and coherent approach to trade policy may seem daunting, but most of the interventions are for improving institutional effectiveness in its present form. The EU's proposed capacity building under its trade policy support program (TPSP) addresses much of the training needs. The EU TPSP targets three institutions: the MoC, EPB, and BFTI. Besides the "Comprehensive Trade Policy," designed to provide a road map for institution for production and exports, training programs targeted at these entities at functional levels fulfill a significant void highlighted in the above diagnostics. In particular, training of key MoC officials (including on trade policy, WTO agreements and trade-related data sources, and trade negotiations including regional trade agreements) are in line with the recommendations of the DTIS. The additional interventions need to be viewed as necessary complements to operationalize the new trade policy-making architecture.

4.1 Ministry of Commerce

4.1.1 Training and Capacity Building

4.74 In order to mitigate the impact of the civil service rotation policy and facilitate effective administration of key areas of trade policy, a consistent stream of training, targeting deputy secretaries, assistant secretaries, and the support staff at MoC should be considered. The training should focus on basics of trade policy, as well as multilateral, bilateral, and regional trade, including the WTO agreements. Additional training should focus on identification of interests and options in multilateral agreements, how to prioritize negotiating positions on bilateral and regional agreements, and trade diplomacy (the latter targeting the higher officials). In addition, joint secretaries and directors should be exposed to the new trade agenda defined by trade competitiveness; traditional trade policy, especially the impact of tariff and NTBs on trade; the behind-the-border and regulatory dimension of trade reform; and the importance of the international supply chain.

4.1.2 Data and Analytical Competence

4.75 The MoC is constrained by the lack of data and analytical resources it needs to keep abreast of the developments within WTO and FTA negotiations, provide traders and public with trade information, and undertake basic research on trade issues for the benefit of trade policy-making, negotiators, and advocacy. First, the MoC has a weak data network for securing and disseminating user-friendly trade data. At present, the MoC's Export Wing receives data from the EPB, which are only in aggregated form (harmonized classification 2-digit level). Data are presented by the EPB to the Export Wing monthly or annual format, which are then distributed to other wings. A framework for receiving up-to-date product-level (6-digit, at a minimum), country-wise, and sector-wise data for dissemination within the different wings and for traders and public are core functions of a typical ministry, but are absent in Bangladesh. The MoC should coordinate with Bangladesh Bureau of Statistics (BBS) to develop such a trade database.

4.76 MoC maintains a very rudimentary website inadequately designed to deliver the public at home and traders abroad basic trade-related data and information. For example, the existing website provides an introduction to the different bilateral trade agreements and FTAs, but offers no information on concessions available or utilization of existing FTAs (such as the share of exports benefitting from preferential duties and rules of origin). A fully integrated website with access to all legislation pertaining to trade policies and a portal dedicated to interacting with various stakeholders is a prerequisite for a new trade policy consultation. In addition, the website should provide information on WTO notification and GATS inquiry points and access to trade statistics (or a linkage to available sources such as BBS). In order to operationalize the broader stakeholder consultation agenda, the Planning Cell (Wing) needs adequate IT equipment and systems, including help-desk support, e-mail, and electronic file sharing through secure Web-based platforms.

4.1.3 Legal

4.77 Currently there is no internal capacity to assimilate and interpret legal implications of trade agreements, including those of the WTO. This void is fulfilled routinely through the Law Ministry's "Drafting Wing" or other entities. For example, in the recent case of antidumping sanctions imposed by Turkey, the MoC sought counseling from a private sector WTO expert (PhD from Oxford) on a pro bono basis. A more expedient option, as an interim measure, would be the secondment of a legal expert trained in trade issues from the Ministry of Law to provide legal advice to the MoC. There is sufficient demand within the MoC for a permanent legal advisor. The duties would include interpreting treaties and other international agreements in relation with MoC functions. The advisor would also draft, vet, and approve agreements, memoranda of understanding, and any other legal documents required by the MoC, including interpretation of domestic law related to MoC or agencies under MoC in accordance with the Federal Constitution.

4.2 Supporting Bangladesh Tariff Commission's Core Mandates

4.78 In its present form, the BTC does not demonstrate the requisite capacity to reestablish the leadership role in tariff setting that is currently held by NBR. The status of its role in tariff-setting must be further examined in hand with reestablishing its leadership on antidumping, safeguard, and countervailing measures, since the tools are already in place and the BTC has the legal mandate to adjudicate antidumping and countervailing duty measures. This would reduce the incentive to misuse tariffs in the protection of domestic industries and would require a robus process to determine injury. In order to build the BTC's role in trade policy and negotiations, capacity building should focus on issues related to the WTO and regional trade agreements, research and analytical skills to support trade policy analysis, and data management.

4.3 Strengthening the Training Role of the Bangladesh Foreign Trade Institute

4.79 The BFTI was established as a nonprofit research and training institution with the Minister of Commerce as the chairman. It was tasked to enhance the trade and business knowledge of the government (especially the MoC) and private sector through research, policy advice, and education and training on issues such as WTO and FTAs.

4.80 The TPSP program of EU is focused largely on building the BFTI's capacity as the research arm of the MoC. The sustainability of this effort needs to be clearly established, given the difficulties associated with attracting and maintaining staff with the requisite skill sets. At the same time, the program overlooks the BFTI's role as a training institute, including the mandate to provide both specialized and general training on trade and business issues for officials of the government and the private sector. Given the deficit in basic training of trade officials within the MoC, and in light of the rotation of civil servants, the BFTI's role should be to help address the training needs of both the MoC and other trade-related agencies.

4.4 Capacity Building for Policy Makers

4.81 Policy makers, especially secretaries and additional secretaries of the ministries of commerce, industries, and agriculture, could benefit from programs such as the Practitioner Knowledge Exchange on Economic Reform of the World Bank Institute (WBI). This WBI program could facilitate the exchange of knowledge and experience among policy makers, using a combination of face-to-face activities, videoconferencing, and interactive online discussions. These exchanges often draw on the expertise of top experts, academics, ministers from developing country governments, and central bank governors, who share their views on existing and new approaches to development and associated policies. The WBI also designs and delivers learning programs on Leadership and Coalition Building to support "change agents" in their efforts to effect reforms in various sectors of the economy.

4.82 In addition, study tours for policy makers could expose them to systems and practices of successful reformers such as India, Malaysia, and even the United States. The tours could focus on building capacity for the key institutional reform areas identified here, including the process and institutional arrangements for formulating tariff policies, standards, and other nontariff measures, among others.

4.5 Outreach Activities for Civil Society

4.83 More inclusive and transparent trade policy making also requires a broader outreach strategy. This includes continued efforts to encouraging dialogue and exchanges of views and ideas between the MoC and civil society representatives (such as NGOs, rural farmers, and social service organizations, both local and international) on trade-related and development-related issues. In addition to the introduction of trade issues in laymen's terms, the MoC and civil society representatives are encouraged to consider their respective roles in multilateral processes and ways to increase public awareness of the

international trade agenda. These may take the form of workshops in Dhaka and other major economic centers (perhaps Chittagong and border areas such as Benapole and Agratala).

5 Conclusion and Recommendations

4.84 The foregoing analysis points to a number of weaknesses in Bangladesh's current institutional framework for trade policy making, including the following:

- The lack of a cohesive and uniform trade policy-making strategy to guide the direction of trade policies and the dominance of narrowly vested interests (such as the protection of selected large industry players and revenue considerations of NBR) in designing trade policies
- Frictions in coordinating the different government agencies engaged in policy making
- A narrowly based consultation with the private sector
- The lack of rigorous research and analysis to support policy formulation and evaluation
- Deficits in skills and capacities within the individual institutions to effectively implement policy reform.

4.85 Summarized below are some broad recommendations for improving the trade policy-making framework in each of these areas.

- Adopt a Strategic Trade Policy Agenda. It is recommended that the Government of Bangladesh adopt the recommendations of this DTIS, which provides the analytical foundations for many elements of a strategic trade policy, and support ongoing EU efforts on trade policy, to form the foundation of a strategic and cohesive trade policy strategy to govern import and export policies, tariff reform, trade-related aspects of industrial policies, and other policies affecting non-tariff barriers, such as standards formulation. The trade policy agenda should be adopted at the highest levels of Government, e.g. through the Council of Ministers, to promote consensus between the different ministries and agencies engaged in formulating and/or implementing policies affecting trade. The goal is to create an overarching set of objectives for trade policy, aligned with Sixth Five-Year Plan and Vision 2021, to form a coherent strategy that the other policy mechanisms will support, eliminating conflicts and counter-productive policies.
- Strengthen Mechanisms for Interagency Coordination. In order to reinforce the Strategic Trade Policy Agenda, serious consideration should be given to rationalizing the current institutional framework to clarify roles and responsibilities and create a more formal process for mandated coordination that creates greater accountability and transparency. Specific aspects of such a rationalization should include the following:
 - Integration or merger of MoC's Import Policy and Export Policy Wings. As the first component of the rationalization, it is recommended that the two Wings be merged into a single Import-Export Policy Wing, backed by a process that aligns the two Policy documents toward a single set of objectives to provide better harmonization between the Import and Export Policies that reinforces the GoB's stated objectives to promote trade-led development.
 - Improved Coordination between Ministries of Industry, Commerce and Finance on Import, Export and Industrial Policies. Related to the above, it is recommended that inter-agency coordination on Import, Export and Industrial Policies be strengthened through the establishment of a standing inter-agency committee, comprised of the merged Import-Export Policy Wing and the relevant Wing of the Ministry of Industry. The goal of this committee will be to better harmonize trade policy measures, including a consistent approach to balancing the interests between exporting and domestic-oriented industries. This would include the selection of "thrust industries" that are granted incentives to promote export growth. On the implementation side, greater coordination between the EPB, MoF and Bangladesh Bank will be required to ensure that incentives are aligned, with increased monitoring by the standing inter-agency committee.

- A Formal Mechanism for Tariff Setting. A clear delineation of roles and responsibilities with respect to tariffs and other import duties that limits rent-seeking behavior is urgently required in order to improve transparency and reduce rent-seeking behavior, and ensure a balance of interests are considered, beyond revenues and individual special interests. This includes the establishment of a joint committee comprising the MoC, through the merged Import-Export Policy Wing, and NBR that will bring a greater balance between the interests of export industries, domestic industries and revenue collection. This must be accompanied by a transparent consultation process with strict criteria for changes to the schedule outside a standardized tariff-setting cycle.
- A Structured Vetting Process for Standards and other NTBs.In the case of standards, implement a more structured vetting process through a formal committee framework that is tied to transparent consultation and research and analysis, including use of the tools of regulatory impact analysis, to better ensure that TBT and SPS measures are not unnecessarily restrictive.
- Similarly, in the case of other NTBs, conduct more rigorous and transparent vetting and impact analysis, with broader stakeholder consultation, to guard against protective measures that impose undue costs on the broader economy (the BUILD framework may be leveraged); and increase reliance on contingency trade remedies to address unfair competition from imports or import surges that threaten domestic industries in place of protective bans and restrictions.
- Promoting Greater Consultation with Bangladesh Bank. A number of other policies that, while not directly under the purview of "trade policy", have a potential impact on competitiveness. These include such policies as the LC margin and exchange rate, which are undertaken directly by the Bangladesh Bank. While the importance of maintaining the Bank's autonomy in setting such policies is recognized, in order to promote a culture of greater transparency and accountability it is recommended that some form of consultation would be appropriate, perhaps through an Advisory Council, based on the US Federal Reserve's Advisory Councils, with representatives from the Ministries of Commerce and Industry, as well as from private sector associations to discuss the impact of monetary policies on competitiveness.
- Broaden Stakeholder Consultation and Improve Transparency. Broaden the reach of consultation to engage SMEs, labor, consumers, and others in civil society as well as the trade-related implementing agencies (e.g. EPB, BEPZA, BOI):
 - *Establish Competitiveness Council.* Consider establishment of a Competitiveness Council or similar body that can provide strategic direction to government on trade policy and its integration into a broader competitiveness agenda-membership would be 50:50 public-private, with representation from MoC, EPB, BEPZA, BOI, and key private sector chambers, sector associations, and SMEs.
 - *Expand BUILD to Address Trade-Related Regulations*. Leverage the BUILD framework, which includes SME representation, to address trade-related regulatory issues (including, again, vetting processes that prevent bad polices from being introduced, such as regulatory impact analysis).
 - Inclusive and Transparent Stakeholder Consultation. Enable inclusive consultation and transparency through new, standardized mechanisms, including open tools to promote dialogue and feedback on policy (making the draft policy recommendations available online and once established making available through Gazette notifications etc.) and established standards of consultation. It is recommended that a single unit, such as the MoC's Planning Cell, take responsibility for putting in place and monitoring these mechanisms and their standard operating procedures for the functioning of standing or *ad hoc* committees, as well as procedures for conducting broader stakeholder outreach. The individual policy wings and

cells within MoC and its agencies would then be responsible for implementation/utilization of the established mechanisms. This will require that all units have adequate IT equipment and systems for managing file sharing and communications.

- **Strengthen Research and Analysis.** A number of intermediate steps can strengthen the rigor of research and analysis to support policy formulation and monitoring and evaluation. This includes a number of different types of research and analysis, including providing periodic reports on trade developments, including Pakistan's own performance and other regional or international trends; the *ex ante* analysis necessary to formulate the periodic Import and Export Policies and analyze the impacts of trade agreements under negotiation, including tariff and non-tariff concessions, rules of origin, and other aspects of agreements; tracking, assessing and recommending policy options in response to national, regional and international economic trends and shocks; responding to the policies and strategies of related ministries as they impact the trade environment; and monitoring and assessing the impact of trade policies, including the Import and Export Policies.
 - 0 Build Analytical Capacity within Relevant Government Bodies through a Central Trade Analysis Unit. The MOC and its agencies (BFTI and BTC) should have at its disposal a minimum in-house capacity to support trade policy decisions, including the tracking and analysis of industry trends impacting trade or resulting from trade policy (for example, calculating effective rates of protection), the analysis of trade policy and FTAs using simple partial equilibrium modeling and scenario analysis, and the analysis of the impacts of domestic regulations on trade. A comprehensive program should be developed, in coordination with the donor community, to develop such capacity through a single unit, perhaps the BTC's Trade Policy unit. This would include training on the use of standardized tools from World Bank, ITC and others. This should be complemented by high-level training to officials within the various wings and cells of MoC, BTC, and BFTI to develop a basic knowledge and understanding of research and analytical results and uses in policy-making. The BFTI, as the primary training mechanism for trade issues, should be the recipient of a train-the-trainers program to ensure that such training can be sustained through the development of its own curricula and materials for both research and non-research staff.
 - Develop a Data Management Center. To support the Government's ongoing research needs and address gaps in data, it is recommended that a data management center be incorporated into the proposed research unit within BTC Trade Policy Unit, as a central resource for access to domestic and international trade databases, domestic production data, and other research and information sources. A simple, web-based system could be developed to provide Government researchers with access to domestic (e.g. detailed Customs data) and subscribed data sources, many of which are available for free to the Government, through the World Bank, UNCTAD, ITC and others. The system could also be configured to generate automatic reports, with data derived from selected sources and generated on a regular basis (such as monthly trade data).
 - Strengthen Linkages with External Research Institutes. While basic analytical skills would be developed within the MoC, BTC and BFTI, the Government will require more complex trade policy analysis, such as advanced statistical modeling and/or general equilibrium modeling, from time to time to support policy-making and trade negotiations, as well as independent analysis. It is recommended that linkages with existing research and policy institutes, such as BIDS, CPD, PRI and academic institutions, be strengthened in order to engage researchers throughout the policy-making lifecycle. Should the PFF be launched, the new institution could be leveraged, as well, to provide analytical support on tariff and tax-related analysis. In parallel, the central trade policy unit would need capacity building to better coordinate and

manage research carried out by external researchers, including the ability to define its research requirements.

- Appoint an Economic Advisor. Lastly, it is recommended that the Government seek donor assistance to recruit an Economic Advisor, to be embedded at the MoC, to provide high-level advice to the Minister of Commerce and to support capacity building within the MoC and other trade-related bodies. The role of the Economic Advisor would be to provide overall strategic advice to the Minister of Commerce and its implementing agencies on the development and implementation of a cohesive Strategic Trade Policy Agenda, to help direct trade policy formulation, engage with think tanks, and support the development of analytical capacity within the BTC, with the aim of enabling the BTC to play a more prominent role, in this respect, over the longer term.
- Build Institutional Capacities. The following outlines key capacity building areas:
 - At the MoC, the following key capacities need to be built:
 - Train staff (through BFTI, see below, and through available World Bank Institute, ITC, UNCTAD and other international programs) on trade policy; multilateral, bilateral, and regional trade; identification of interests and options in multilateral agreements; prioritizing negotiating positions on bilateral and regional agreements and trade diplomacy/negotiations. This latter area will be targeted specifically at senior officials at MoC and BTC that are actively engaged in negotiations, either at WTO or through regional agreements, and provided by BFTI (see below).
 - Consider options for providing legal expertise in the MoC on a permanent basis as there
 is sufficient demand within the MoC either through direct hire or on retainer through a
 local law firm or, if neither of those options are feasible, through the secondment of a
 legal expert from the Law Ministry. Depending on available capacities, further training
 on trade law may be required.
 - *At BTC:* Build capacity as shared in-house resource for trade research, analysis and data management to enable the BTC to fully develop its role as the primary source of trade policy advice to the MoC and the rest of the Government.
 - At the BFTI: Given the constraints imposed by the civil service rotation practices, there is a need to build a sustainable framework to address the many gaps in human resource skills and capacities at the MoC and its agencies. There is an opportunity to strengthen the BFTI, through a train-the-trainer program, to provide ongoing training and professional development to the other trade-related agencies with ongoing external training reserved for more advanced skills development, to supplement BFTI programming. Two separate set of curricula are recommended to build the basic analytical capacity of trade officials in the MoC and other trade-related institutions to provide a consistent broad level of knowledge of basic principles of trade policy, the role of the WTO and its agreements, trade negotiation skills, and the role of regional trade integration. A number of sources of existing training modules are available through WTO, WBI, UNCTAD, ITC and others that can be leveraged to design a train-the-trainers program and curriculum. Illustrative BFTI Train-the-Trainers Program

Basic Principles of Trade Policy

- Process within the Ministry of Commerce
- International Trade Policy
- Principles of Trade Theory
- Basics of Empirical Analysis
- Overview of Bangladesh's Trade Agreements
- Bangladesh Trade Policy Regime
- Industrial Policy
- Principles of Industrial Policy Theory
- Overview of Bangladesh's Industrial Policy Regime

Analytical Tools for Trade Policy Research

Quantitative Policy Analysis Tools

- Trade Indicators and Use of WITS and other Indicator Databases
- Partial Equilibrium Analysis
- Introduction to Forecasting Techniques
- Interpretation of CGE Models
- Cost/Benefit Analysis and Impact Assessment Methodologies

Economic Data

- Survey of National Data Sources
- International Data Sources
- International Reports
- Assessing the consistency and reliability of data

Trade Negotiations

- Role and Development of Negotiations in Commercial Diplomacy
- Overview of Trade Negotiations
- Elements of Interest-based negotiations
- Identification of Problems and Opportunities
- Establishing Negotiating Goals and Objectives
- Research, Planning, and Pre-Negotiation Negotiations
- Skills To Employ at the Negotiating Table
- Drafting Agreements
- Dispute Resolution Mechanisms
- Modules on Specific Trade Agreement Topics (agriculture, Services, Rules of Origin, TRIPs and IPR, Trade Facilitation, SPS, TBTs,

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Annex A. Tables and Figures



Figure 4A.1: Ministry of Commerce Organizational Structure

AS Additional Secretary DS Deputy Secretary SAS Senior Assistant Secretary AS Assistant Secretary Dir Director DD Deputy Director AD Assistant Director, SAC Senior Assistant Chief

Figure 4A.2: Organizational Structure of TC



JS: Joint Secretary, DS: Deputy Chief, AC: Assistant Chief, RO: Research Officer



Figure 4A.3: Current Organizational Structure of BFTI

Box 4A.1: Export Policy and Priority Sectors Incentives

Export policy stipulates General Provisions for Export, Steps toward Export Diversification, General Export Facilities, and Product-Specific Export Facilities. Under General Export Facilities, Export Policy enunciates an Export Promotion Fund (providing venture capital at lower interest rates and with soft terms for production of goods, exhibitions, etc.) and other financial facilities (incentives such as tax exemptions and cash incentives, export credit, and exemptions from insurance premium, bond facilities, air freight and other subsidies). Export Policy also contains provision for prohibited products and products subject to "conditional exports."

As a step towards augmenting and diversifying exports, Export Policy also stipulates (i) "highest priority sectors," referred to as "products and sectors which have special export potentials, but such potentials could not be utilized properly due to certain constraints, and more success is attainable if adequate support is rendered to them"; and (ii) "special development sectors," referred to as product/sectors "which have export potentials but whose production, supply and export base are not consolidated." Export Policy further states that "government will regularly modify this list, and provide special privileges to encourage the export of these products."

Box 4A.2: Standards of Consultation

Standard of consultation. Create a standardized format for consultation documents, such as a summary of policy goals, main issues, and options, to permit easier access by stakeholders.

Scope of consultation (policy decisions). Make consultation accessible to all businesses and stakeholders.

Method of consultation. Build a unique Internet website for publication of and consultation on draft regulations and decisions. This would significantly improve visibility and accessibility of ministerial documents and place the MoC within the mainstream of international practice. Plan, for example, to publish open public consultations that are announced at a "single access point" or central webpage. Timely information, meeting dates, and agendas should be available to participants well in advance. Short reports on meetings should also be produced and distributed as soon as possible.

Timing of consultation.

- 1. Revise procedures inside the MoC to require consultation early in policy development, before drafting is done, to improve the quality of documents submitted to the minister.
- 2. Allow sufficient time for response to information. Ministry staff should allow at least eight weeks for responses to written public consultations and 20 working days for meetings.
- 3. Receipt of contributions should be acknowledged.
- 4. Results of open public consultation should be displayed on websites linked to a single access point on the Internet.
- 5. Ministerial reactions to stakeholder comments should be summarized in the final policy decision.

Source: OECD 2010.

Box 4A.3: National Institute of Public Finance and Policy (NIPFP) of India

Objectives: The National Institute of Public Finance and Policy (NIPFP) was founded in 1976. It is an independent center for excellence in applied research in sustainable public finance policy for development, including strong advocacy and capacity development of public and private institutions.

Governance: NIPFP's governing body comprises three eminent economists, taxation experts, and twelve other members representing state governments, research institutions, scientific societies, chambers and senior officials from the Ministry of Finance. NIPFP works closely with the Department of Economic Affairs (DEA) of the Ministry of Finance and the Chief Executive Director of NIPFP is a member of the Economic Advisory Council to the Prime Minister of India. The Advisory Board of the DEA of the Ministry of Finance provides overall policy guidance to NIPFP, while a steering committee headed by the Secretary of the DEA reviews various policy notes and outlines future areas of research.

Funding: The NIPFP receives an annual grant-in-aid from the Ministry of Finance (Government of India), and from various state governments. This grant is supplemented by funds from its sponsoring, corporate, permanent, and ordinary members.

Key Activities: NIPFP's three major activities encompass research, training, and advocacy work.

- *Research:* Major research work includes on contemporary fiscal issues; several studies on central, state, and local finances; and studies on neighboring countries. Over NIPFP has also conducted over 230 sponsored studies on tax systems of central, state, and local governments; indirect taxes enquiry committee; reform of domestic trade taxes in India; GST reform; other state and local taxes; and public expenditures. NIPFP also provides fee-for-service consultancies within and outside India.
- *Training:* Training programs in the form of day and residential courses, lectures, workshops etc. are organized for government and nongovernment officials, as well as international participants.
- *Advocacy:* NIPFP identifies various public interest-related issues and conducts advocacy through dissemination events. These advocacies have had significant influence on the policy making of the government of India.

Sources: Knowledge Sharing Workshop: Visit to National Institute of Public Finance and Policy (NIPFP); India Finance Division, Ministry of Finance and the World Bank, Bangladesh, November 8–9, 2010.

Box 4A.4: Australia's Productivity Commission

The Productivity Commission of Australia is set up as principal evaluation and advisory body on microeconomic policy and regulation. It conducts rigorous and authoritative quantitative estimates of the costs of trade barriers and other forms of government assistance to industries to consumers and to the economy as a whole. These have helped persuade policy makers of the merits of trade liberalization, transparency, and independence. The evaluation of economy-wide effects of policies has become three fundamental principles of the Productivity Commission and its predecessor—all essential attributes that are currently missing from current policy-making apparatus in Bangladesh. Before discussing the shape and form of how the Productivity Commission may be relevant, it is incumbent to understand the commission's evolution. It operates independently, under the authority of an Act of Parliament, *as an advisory body*. The commission has a chairman and commissioners who are statutory appointees, and they cannot be removed except by parliament. Transparency is ensured through the commission's public hearing process and its public release of inquiry and annual reports.

The Productivity Commission has the following personnel:

- Associate commissioners, who enhance the work of the commission and the community's understanding of the commission's approach. Although usually appointed for their expertise on a particular inquiry, some have been appointed on a permanent basis.
- Recruited staff with economics and quantitative skills; especially key staff with highest quantitative acumen.

The Productivity Commission Act specifies that the commission's formal functions are as follows:

- Hold inquiries and report on matters relating to industry development and productivity.
- Provide secretariat and research services to government bodies such as the Council of Australian Governments.
- Investigate competitive neutrality complaints.
- Initiate its own research on industry development and productivity.
- Promote public understanding of industry development and productivity matters.
- Undertake other functions, including providing advice to the treasurer, on request, on industry development and productivity matters.

These functions translate into a wide range of activities:

- Government-commissioned projects
 - major inquiries with public hearings
 - inquiries without formal hearings
 - public inquiries on safeguard action against imports
 - evaluations of departmental programs
 - advice to the treasurer
- Standing research and advisory responsibilities
 - Commonwealth/state service provision for the Council of Australian Governments
 - performance monitoring of government trading enterprises
 - international benchmarking, especially of economic infrastructure
 - case studies on workplace arrangements
 - regulation review, including advice to the cabinet, vetting, and compliance monitoring
 - competitive neutrality complaints mechanism
 - annual reporting on productivity, assistance and regulation
- Supporting research

Source: Australian Productivity Commission 2000.
Meeting the Quality Challenge: Technical Regulation, SPS measures and Quality Infrastructure in Bangladesh

1 Introduction

5.1 In the future, Bangladesh's ability to harness economic opportunities from global trade will depend on its management of the quality of the products it exports and imports. Bangladesh faces a quality challenge for both its exports and imports. For exports, buyers and importing countries will set more stringent standards and technical regulations in the future. The success of Bangladesh's attempts to develop and diversify its exports will depend on how the country meets this quality challenge. Simultaneously, in the future the population of Bangladesh will demand better regulation of imports to address an expanding array of issues, like public safety, food safety, and plant and animal health.. Meeting the quality challenge in both export and import markets will help maximize trade, accelerate growth, and eradicate poverty.

5.2 This chapter assesses the quality challenge. It argues that in export markets quality management is essentially a private undertaking, but the government and the donors that support it play a key role in setting the rules right and providing support infrastructure and technical assistance. It is the private sector that picks markets and has to comply with the quality requirements. The role of the government is to help producers, notably small and medium enterprises (SMEs), meet quality standards and with an appropriate supply of national infrastructure. This supply usually consists of a combination of private and government services for quality, supplemented by imported services.

5.3 This chapter focuses on the key concerns of meeting quality demands in Bangladesh. Due to the complex and dynamic nature of the quality challenge, the chapter is necessarily nonexhaustive. Careful choices were made to ensure that this chapter was not too large and or detailed to be of use to the practitioner. The chapter does not discuss all—or even a majority—of the specific standards and quality requirements that Bangladeshi exporters face. These specifications change so rapidly that detailed information would soon be outdated. Timely specifics should be sought elsewhere. The chapter focuses on general issues and includes specifics only to illustrate generic points.

5.4 The chapter supplements existing material on how developing countries may meet the quality challenge. Many international agencies have produced guides and handbooks on quality policy and export development.⁵⁶ Most such publications draw heavily on the experiences of high- and middle-income economies and less on economies like Bangladesh. Therefore, this chapter occasionally deviates from

⁵⁶ Such agencies include the International Trade Centre (ITC), the International Organization for Standardization (ISO), the United Nations Industrial Development Organization (UNIDO), and the World Bank; and bilateral agencies like the German Metrology Institute (PTB) and the Swedish International Development Coooperation Agency (Sida). For examples of specific publications, see Foss (2004), Guasch et al. (2007), ISO and ITC (2010), ITC (2011), and Kellermann (2011).

some common recommendations. Notably, the chapter urges prioritization and exploitation of the capacities of private market suppliers of services for quality where these exist. To develop an appropriate quality system, the scarce resources and capacities of government institutions must complement existing private efforts rather than replace them. The garment industry, for example, uses services for quality like testing and certification extensively and this demand is met satisfactorily by private suppliers.

5.5 The chapter is based on stakeholder interviews and existing research on the challenges Bangladesh faces with respect to technical regulation, sanitary and phytosanitary (SPS) measures and quality infrastructure. The authors visited Bangladesh from March 18 to March 29, 2012, and again from November 24 to December 13, 2012. Officials in the Bangladeshi government were interviewed (at the Ministry of Commerce, the Bangladesh Standards and Testing Institute, Plant Protection Wing, and Department of Fisheries). Private sector and nongovernmental stakeholders were also consulted, including industry associations (Dhaka Chamber of Commerce and Industry), individual firms (in garments, footwear, ceramics, food, and quality service providers), donors, and academics. The chapter was finally revised following a validation workshop in Dhaka on October 22-23, 2013.

5.6 The chapter is structured as follows. The next section presents background information on international best practice. The third section identifies Bangladeshi export quality requirements and discusses how Bangladesh meets them. The fourth section presents Bangladeshi import regulations and analyzes the operation of two major import regulation agencies, the Bangladesh Standards and Testing Institute (BSTI) and the Plant Protection Wing. The fifth section reviews quality-related barriers to trade between Bangladesh and India. The last section concludes and makes policy recommendation on how to improve Bangladesh's technical regulation, SPS measures and quality infrastructure.

2 Background

5.7 When judging the way a country meets the quality challenge, two approaches dominate. The first approach, which we call the benchmark approach, uses international best practices as a benchmark. Reform is directed toward incorporating international best practice into the country's quality system. The second approach, which we call the demand assessment approach, analyzes and identifies the country's needs in terms of export markets requirements, domestic demand for consumer protection, demand for technical interoperability of components, and so forth. Demand assessment seeks to tailor reform to the challenges the country faces. Although these two approaches appear conceptually distinct, in practice, the practitioner will often use them in combination.

5.8 Below, this chapter will elaborate on these two approaches, but first a discussion about terminology. The key concept 'quality' is in one way in the legal literature much inspired by the Agreement on Technical Barriers to Trade (TBT Agreement) of the World Trade Organization (WTO) and in another in the vast literature on quality management. The legal literature distinguishes sharply between 'quality' and 'safety', thus a fruit, for example, has quality characteristics like taste and color and 'safety' characteristics like pesticide residues. The reason for this distinction is that the TBT Agreement allows government to regulate what it understands as safety issues but not quality. In the quality management literature, the concept of 'quality' is broader and includes whatever characteristics may cause two variants of a product to differ. Thus in this tradition safety characteristics are just another form of quality characteristics. This chapter used the quality management are used to control all sorts of quality characteristics including what a WTO lawyer would call safety.

5.9 The benchmark approach has been used to evaluate the needs of many developing countries, and to inform capacity building for standardization and quality. The approach addresses two basic problems. First, while many practitioners refer to international best practice, there is no consensus on what it contains. Best practice likely varies with the country context. Second, technical regulation and the quality

infrastructure are very basic in many developing countries. Thus, benchmarking with any given definition of best practice yield so many deficiencies that prioritization becomes very difficult without further analysis.

5.10 The demand assessment approach suffers from severe methodological difficulties. Cost-benefit analysis and similar economic valuation methods are conceptually simple and often recommended. Yet in practice, these methods depend on the availability of data, as well as human and financial resources that are in limited supply in developing countries. The practitioner therefore often combines the two approaches, for example by using the benchmark approach to focus the demand assessment on a few alternative policy choices. The benchmark approach may also be used as a quality control of the outcome of a demand assessment. If the demand assessment leads to recommendations of a policy course contradicted by best practice lessons, great care should be taken to argue for the deviation. In essence, deviations from international best practice in a country's quality system should always be substantiated in objective circumstances, like institutional weakness.

Box 5.1: Quality Infrastructure Components

Quality requirements: Quality requirements specify the nature of a product, including its production methods as demanded by buyers or regulated by regulatory agencies, both of which may be either domestic or foreign depending on the end market of the product. Quality requirements may be expressed as purely private requirements determined by a single buyer or a group of buyers, as formal standards, or as technical regulations. Some private quality requirements may operate like standards in the market place, due to their market dominance.

Standards: Standards are codified quality requirements providing the basis for the evaluation of compliance with the demands of buyers and regulatory agencies. Standards may be set by a variety of actors, including national, regional, and international bodies. National standardization bodies (NSBs) bring together public and private stakeholders to develop formal consensus on national standards. Such standards may become international standards if adopted by international standardization bodies following certain procedural rules about the development of standards. Following the TBT Agreement by the WTO, compliance with standards is voluntary.

Technical regulations: Technical regulations are mandatory quality requirements providing the basis of the regulation of legitimate issues like product safety or environmental protection. Technical regulations are highly variable, ranging from very prescriptive to those that mostly set general objectives, thereby allowing the private sector the choice of how to comply. Often, technical regulations refer to standards as the technical basis of regulation. This approach ensures that a consensus exists between public and private sector actors on the most efficient ways to comply with regulation. In some countries (*e.g.* Bangladesh), technical regulations are often called 'mandatory standards', a contradiction in terms according to the TBT Agreement.

Conformity assessment: The process of ensuring those quality requirements are met, for example testing, inspection and certification.

*Testing and inspection:*Testing and inspection demonstrate compliance with quality requirements, standards, and technical regulations. Testing and inspection may be done by first parties (in-house), second parties (buyers or regulatory agencies), or third parties (bodies independent from both transaction parties). For many needs, testing and inspection services are tradable. Small and large service providers supply testing and inspection services across borders and in developing countries, typically to exporters.

Certification:Certification is the assurance by an independent body that a product, services, system, or process conforms to quality requirements, standards or technical regulations. The certification bodies are often private but may also be public, especially in markets for which conformity assessment services are little developed. As with testing and inspection, certification services are tradable and a large number of global firms provide such services across borders.

Accreditation: Accreditation is the assurance by an authoritative body (the accreditation body) that an organization or person is competent to conduct specific tasks. Conformity assessment bodies undertaking testing, inspection, and certification can seek accreditation on a voluntary basis as proof of competence in a given area. The accreditation body may be a domestic or a foreign entity. More-developed countries often have a single national accreditation body responsible for all areas.

Calibration:Calibration is the comparison of measuring equipment against a standard instrument of higher accuracy. Firms often use calibration laboratories to calibrate their measurement equipment, although some firms calibrate their own equipment. Private or public service actors may provide calibration services that may be produced domestically or imported.

Metrology: Metrology is the science of measurement. More developed countries have established a national measurement system designed to maintain, develop, and diffuse measurement standards. This system provides calibration services to independent calibration laboratories and other institutions involved in measurement. Calibration laboratories in turn provide services to firms and public sector agencies using measurement equipment. Measurements are traceable through a chain of comparisons back to the national system and eventually to global measurement standards, thereby guaranteeing the accuracy of the primary users of measurement equipment.

2.1 Best Practice in Drafting Technical Regulation and Standards

5.11 The concept of international best practice plays a central role in the discussions of a country's quality system. This section seeks to discuss what international practice is and how good practice may vary with country contexts. While many observers and practitioners refer to the concept of best practice, no commonly accepted definition exists on what it is. This chapter discusses best practice using three sources of information.

5.12 First, recent joint work by the Organisation for Economic Co-operation and Development (OECD) and the Asia-Pacific Economic Cooperation (APEC) has searched for common ground on the understanding of best practice. The memberships of the OECD and APEC cover the major part of the world economy and this initiative subsequently constitutes the initiative with the broadest anchor currently available. In addition, The OECD and APEC have developed a joint work program on regulatory reform (OECD and APEC n.d.). Among the program's outcomes is a checklist on regulatory reform and a note entitled "Information Notes on Good Practice for Technical Regulation" (APEC 2000). The checklist is meant to be used by economies desiring to move closer to good international practice by establishing a framework of key concepts for decision-makers. The note discusses elements of best practice more specifically for technical regulations and conformity assessment.

5.13 Second, the WTO SPS and TBT agreements also contain guidance on international best practice in regulating quality issues, notably with respect to minimizing the trade restrictiveness of a country's quality system. The SPS and TBT agreements establish regimes for the implementation of technical regulations. They also encourage and set out rules for the use of trade facilitation instruments, like harmonization, equivalency, and mutual recognition.

5.14 Third, analytical work and capacity-building efforts in developing countries are beginning to influence the understanding of what constitutes best practice. In many developing countries, recent capacity-building efforts by multilateral organizations like the United Nations Industrial Development Organization (UNIDO) and bilateral agencies like the German Metrological Institute (PTB) have generated new thinking on how to best address the quality challenge in developing countries (see, for example, Kellermann 2011; UNIDO 2007). In many least-developed and low-income countries, capacity will have to be built almost from scratch. To establish a quality system that serves the needs of a developing country, careful prioritization of interventions will be crucial and policy measures will need to match a country's human, institutional, technological, and financial resources. The remainder of this section identifies and discusses lessons of best practice as witnessed in the APEC-OECD work program; the WTO SPS and TBT agreements; and in developing country work on quality issues.

5.15 Technical regulations should be used exclusively to regulate a narrow set of legitimate objectives. In many developing countries the institutions working on quality issues—such as NSBs and various government agencies—traditionally see themselves as regulatory agencies rather than services providers to industry and consumers. The international best practice is to reserve technical regulation for a short list of legitimate objectives, such as consumer safety and safeguarding the environment, while leaving other quality-management issues to market forces and private initiatives, often in the form of voluntary standards. Furthermore, a division of labor is established in many successful economies between NSBs and government agencies like ministries. NSBs set voluntary standards while regulatory functions are reserved for the government agencies. Sometimes, government will use the voluntary standards as the basis for the technical regulations they issue, thereby making the regulations voluntary. NSBs are not directly involved in regulatory decision-making but are service providers to industry, consumers, and government.

5.16 Performance-based and prescriptive technical regulations are the two main types of technical regulation. Performance-based regulations focus on defining the objective of the regulation while prescriptive regulations define both the objectives and the means through which these must be met. Prescriptive means reduce the flexibility of industry to choose the most efficient means to comply with

regulatory objectives and furthermore puts great demand for the regulatory authority's ability to deal with complex technical issues. Performance-based regulation is seen as a proper way to decentralize decision making on technical issues to the level where the best knowledge exists, the industry. However, a limited role remains for prescriptive technical regulations in situations where a high degree of control of the compliance process is desirable. Typically, these are situations where there are limited ways of achieving a desired objective or when the problem addressed by regulation is static. Performance-based regulations may introduce uncertainty regarding what constitutes compliance, and may pose difficulties for regulators that monitor and enforce compliance. Furthermore, in high-income countries, performance-based regulations are often used in combination with additional controls like post-market surveillance. The WTO TBT agreement Article 2.8 encourages WTO members to apply performance-based regulations:

Wherever appropriate Members shall specify technical regulations based on product requirements in terms of performance rather than design or descriptive characteristics.⁵⁷

5.17 The major advantage of performance-based regulations is that they can accommodate a range of technical compliance solutions, thus encouraging innovation and technological change.

5.18 The referencing of voluntary standards may reduce the uncertainty of how to comply with performance-based standards if used properly. Regulatory authorities may stipulate that the compliance with certain voluntary standards developed by national or international standard-setting bodies is an optional way of ensuring compliance. This approach provides guidance on how to comply while ensuring flexibility. However, many voluntary standards are not developed to assess compliance and may include many features irrelevant to the question of compliance. Regulatory authorities should exercise care that only aspects of voluntary standards relevant to compliance are referenced by a technical regulation.

5.19 Alignment with international standards reduces the trade restrictiveness of technical regulations. Harmonization may lead to cost savings through economies of scale and lead to the transfer of technology to developing countries. However, the positive effects of harmonization depend on the appropriateness of the international standards with which harmonization takes place. Some international standards address problems for which the optimal configuration of the standards depends on local conditions, such as weather or institutional capacity. The WTO SPS and TBT agreements encourage the use of international harmonization as a trade facilitation tool but stop short of making harmonization mandatory (Jensen and Vergano 2009). APEC (2000) emphasizes that to be valuable for harmonization, international standards must have been drafted through a process that is transparent, open, nondiscriminatory, and that properly reflects the conditions in all countries expected to use the standard. Many international standards are developed without inputs from developing countries.

5.20 Equivalency and mutual recognition are alternative trade facilitation instruments to harmonization (APEC 2000; Jensen and Vergano 2009). Acceptance of the technical regulations of other economies, even when standards are not identical, may still result in efficiency gains for industry and regulators through the means of equivalency and mutual recognition as recognized in the WTO SPS and TBT agreements. The usefulness of these alternative trade facilitation instruments depends on the ability of different economies to achieve the same levels of protection health and safety. For trade between countries with highly varying income levels, this may be difficult. Yet, successful cases do exist where developing countries have established equivalent regulatory frameworks for compliance with highly demanding OECD country regulations. These successes are typified by Vietnam's ability to gain recognition for its regulatory framework in seafood by the European Union (EU), an achievement that has allowed Vietnam to gain EU market access and make the EU its most important seafood destination.

⁵⁷ http://www.wto.org/english/res_e/booksp_e/analytic_index_e/tbt_01_e.htm#article2.

5.21 In summary, a country may take a number of steps to minimize the restrictions that technical regulations impose on domestic industry and trade. These steps include the following:

- Limit the use of technical regulations (in some countries also called mandatory standards) to issues of product safety, environmental protection, and similar issues requiring tight government control. Make standards voluntary when legitimate objectives are not in play.
- When regulating legitimate objectives, adopt performance-based rather than prescriptive technical regulations.
- Ensure that when referencing voluntary standards only the parts of the voluntary standards necessary to achieve the legitimate objective are referenced.
- Use the appropriate trade facilitation instruments (such as harmonization, equivalency, or mutual recognition) to reduce the difference in regulatory requirements across borders.

2.2 Best Practice in Conformity Assessment

5.22 A country should seek to choose the appropriate conformity assessment regime. The appropriate system meets the needs of industry and consumers at the lowest costs, exploits available sources of conformity assessment services (that is, private, public, and imported services) efficiently, and ensures the greatest degree of compliance with technical regulations with the lowest degree of government interference (APEC 2000; Kellermann 2011).

5.23 Inspection is a highly stringent form of conformity assessment and places a significant burden on industry and consumers. Furthermore, inspection regimes often put severe strain on government resources because they demand many personnel and financial resources. APEC (2000) recommends that inspection should only be used in high-risk situations or in cases where the product is constructed on-site and does not reach final form until ready to be put in use (as with buildings, for example). Border management procedures often include testing and inspection activities. Efficiency concerns dictate that the often severely limited public resources available for border management should be directed towards their most effective use. Risk profiling may generate considerably gains in terms of cost-effective inspection and meeting the objectives of regulation. In risk profiling, available product and trader information is used to identify trade most likely not to comply with technical regulations. Border management resources are subsequently directed toward these segments.

5.24 Batch testing samples each batch or shipment of a mass-produced product and reduces the burden associated with testing. According to APEC (2000), batch testing is declining in popularity because increasingly effective quality management systems in firms ensure that each product made has the same quality. Batch testing remains useful when the regulator or buying company lacks confidence that the quality of the product is consistent.

5.25 Licensing assesses the competence of an individual or firm to undertake a specific task. Licensing is applicable in situations where the quality characteristics of the resulting product are difficult to observe. The need for certainty that technical regulations will be met necessitates that competent individuals or firms should make the product. Such individuals or firms should be licensed and the license may be subject to periodical renewal to ensure that competencies are maintained.

5.26 Approvals are currently the most common form of premarket conformity assessment in OECD countries. Approvals involve the assessment of a product sample. The assessment may be done either by a government body or by an accredited test facility. In either case, the regulatory body retains the final decision based on the test to approve or disallow the sale of the product. Approval systems are normally complemented by systems of post market surveillance. Post market surveillance involves the monitoring of products put on the market, including batch testing if necessary, to ensure that the goods on sale correspond to the originally approved product.

5.27 Most certification activities are undertaking effectively and efficiently by private certification companies. Certification is a third-party attestation related to products, processes, systems, or persons. Certification is based on the results of tests, inspections, and audits and gives confidence to the customer or buying company on account of the systematic intervention of a competent third body. In some, mainly developing, countries, the government is active in certification, but for the most part, private companies specialize in the provision of such conformity assessment services. Globally, a range of multinational conformity service providers have developed to serve business and government needs in both developed and developing countries.

5.28 Listing or registration is a less intrusive alternative to approval. Listing or registration accomplishes the same outcome as approval without the direct activity of the regulatory body prior to putting a product on the market. Producers or traders simply submit appropriate documentation such as testing reports. On the basis of this documentation, the regulatory body makes a decision. Listing or registration of products allows the regulatory body to identify the manufacturer or trader should a problem of nonconformity arise. Best practice in the use of approval, listing, and registration is to reserve these instruments for products with critical characteristics relevant, for example, to objectives like consumer safety. Premarket approval may be avoided for products with less critical characteristics.

5.29 Supplier declarations provide significant advantages to industry. Supplier declarations require the producer or trader to demonstrate due diligence in the form of, for instance, testing by a conformity assessment body or the supplier's own testing facility. Supplier declarations allow industry to choose the facility used to demonstrate conformity with technical regulation. Industry is not required to seek approval from the regulatory body prior to placing its product on the market. Such a system leads to time and cost savings to industry and lessens the administrative burden of the regulatory body. Naturally, a minimum level of trust is an essential requirement for the efficient functioning of supplier declarations.

5.30 An efficient conformity assessment regime exploits the potential of the private market. In developed and developing countries alike, quality regulation is only a small part of quality management. Technical regulations address mandatory quality standards, but quality management also deals with non-mandatory requirements such as size, shape, design, and so forth. Non-mandatory requirements are nevertheless crucial for achieving international competitiveness. Quality management, including regulation, is constantly evolving. This is particularly so in developing countries, which are under pressure to meet international requirements exceeding domestic ones and simultaneously meeting the expectations of the local populations to upgrade domestic quality management and regulation. As discussed, complying with technical regulations often involves working with private sector bodies. Similarly, complying with private market requirements in the form of voluntary standards or company quality specifications is often exclusively a private market issue. In this case, the government's role is to allow the private market for quality services to operate efficiently.

5.31 Furthermore, the conformity assessment regime should harness the resources of the global economy. Many conformity assessment services are highly tradable. Simultaneously, many developing country economies are small and lack the capacity to supply necessary quality services. Even among developed countries like EU member states, quality services are often provided across the border.

5.32 In summary, a country may take a number of steps to increase the effectiveness and efficiency of its conformity assessment regime. These steps include the following:

- Use all available sources of conformity assessment services to establish a conformity assessment regime that economizes on scarce public resources and meets regulatory demands as well as other quality management demands.
- Allow private and imported conformity assessment services to complement the national conformity assessment regime.
- Consider carefully the choice of conformity assessment instruments and pick the one that meets the objective of regulation while creating minimal government interference.

• Consider the range of alternative instruments used in more developed economies and evaluate their usefulness in the context of the relevant developing economy.

3 Meeting the Quality Challenge Abroad: How Bangladesh Manages Export Quality

3.1 Quality Requirements for Bangladesh's Exports

5.33 Access to export markets is influenced by many quality requirements that vary greatly across markets. Garments and ceramics are examples of markets where such requirements are predominantly set by private firms. However, some quality characteristics are regulated by importing countries that enforce technical regulations. Garments, for instance, have to comply with, among other things, consumer expectations about design and washing resistance; buyer requirements about pilling, durability, and labor conditions; and regulatory demands from the end-markets about dyes, other chemicals, and heavy metals. These value chains are very much buyer driven; that is, large foreign buyers set the rules including quality requirements. In contrast, seafood is an example of a market in which stringent technical regulations are most important: these are set by importing countries, most notably the EU and the United States. Horticulture is yet another story. The main exports of fresh fruit and vegetables from Bangladesh go to the Middle East, where quality requirements are easy to meet. Some processed and manufactured products are exported to India and are burdened by cumbersome Indian import procedures and the lack of mutual recognition of certification between India and Bangladesh. Table 5.1 illustrates the range of quality requirements that apply to exports.

5.34 Producers need to tailor-make products for buyers. As an example, the Plant Protection Wing of the Ministry of Agriculture, the national Bangladeshi plant health authority, reports that it has received numerous notifications from the EU on the detection of harmful pests on U.K.-bound citrus exports. In collaboration, the citrus producers and the Plant Protection Wing have developed the Bangladeshi plant health system with the aim of meeting the phytosanitary requirements of the EU. Such problems are typical for the extremely stringent EU market. In contrary, the Plant Protection Wing has not received any complaints on sanitary or phytosanitary problems from markets in the Middle East, Bangladesh's largest market for airfreighted fresh produce. Even when receiving apparently similar products, like vegetables for Bangladeshi expatriate communities, the EU and Middle East have very different requirements for food safety and plant health. Successful Bangladeshi exporters carefully target export markets that demand quality characteristics they can comply with. They upgrade their products to target more demanding and higher paying markets in tandem with improving quality management capabilities.

3.2 Export Quality Management in Bangladesh

5.35 Quality management is a necessary condition for successful export performance. Meeting quality requirements in international markets is a multidimensional process, ranging from working in the value chain to ensure that the right quality is produced, to demonstrating that the product meets the relevant quality requirements. The International Trade Centre (ITC) in Geneva has identified four dimensions of quality management:⁵⁸

- Obtaining information about the mandatory technical regulations and voluntary standards applicable in the export market
- Adapting the product to meet these quality requirements efficiently
- Demonstrating that the product meets the relevant quality requirements
- Obtaining the necessary support at each step from the national quality infrastructure

⁵⁸ See www.intracen.org/exporters/quality-management.

Below, we discuss quality management in four export sectors in Bangladesh: garments and footwear, ceramics, fresh produce, and seafood. The discussion uses the four dimensions of quality management identified by the ITC.

	Standards, private protocols, and technical regulations relating to:				
Product group	Quality attributes	Consumer safety standards	Food safety	Plant and animal health	Environmental and social issues
Garments and footwear	Design Durability	Azo dyes Heavy metals EU REACH ^a chemical control program	n.a.	n.a.	Private labor standards and codes of practice Private environmental codes of practice Waste water treatment
Ceramics	Shapes Glaze Decor	Lead and cadmium content	n.a.	n.a.	Private labor standards and codes of practice
Fresh produce	Demand for traditional Bangladeshi varieties by expat Bangladeshi communities Packaging standards	n.a.	Pesticide residue limits Hygiene requirements	Phytosanitary certification Fumigation Pest risk analysis Traceability	n.a.
Seafood	Size Species Taste Color	n.a.	Hygiene requirements Antibiotics residue limits HACCP ^b	n.a.	n.a.

Table 5.1: Illustrative	Ouality	Issues for	Bangladeshi	Export Produ	acts
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Note:

a. European Union's REACH (Registration, Evaluation, Authorization and Restriction of Chemicals) chemical control program. b. Hazard Analysis and Critical Control Points.

n.a. = not applicable.

3.2.1 Garments and Footwear

5.36 Garments and footwear comprise the bulk of Bangladeshi exports. Most of Bangladesh's exports are positioned in the lower-quality segments of EU and U.S. markets. The buyers are a mix of branded companies and unbranded importers selling through discount outlets. Some Bangladeshi exporters are targeting higher-value markets, like more fashion-oriented brands with season-oriented shifts of designs. The quality requirements in this trade are primarily private market standards and company codes, although some importing-country regulations on issues like chemicals (such as dyes) and heavy metals must be complied with also. Bangladeshi producers source market information on quality requirements exclusively through market channels, in particular their buyers. As one exporter put it in an interview: "exporting is about meeting the buyer's requirements." Bangladeshi technical regulations and standards do not play much of a role for the export trade, except for labor standards. Compliance with labor

standards is a growing issue. These standards are formulated both as private buyer standards and codes of conduct and as Bangladeshi regulations.

5.37 In the main garment markets like the United States and the EU, nongovernmental organizations (NGOs) and labor unions have campaigned for better working conditions in the producing countries. The NGOs and labor unions argue that such improved conditions should include, for example, a safe work environment, regulation of child labor, and higher wages. The campaigns have successfully influenced global garment markets and today, the large international brands that purchase most of Bangladesh's garments view compliance with labor standards as a key factor of competitiveness. Initially, each brand created its own corporate code of conduct. But influencing working conditions through private means is difficult because of the structure of the global garment industry. Most Bangladeshi garment producers supply numerous brands and cannot operate with equally numerous and differently formulated codes of conduct. For example, paying workers different wages depending on which brand will buy their output is impractical. Therefore the Bangladeshi government in 2006 adopted a "uniform code of conduct" and updated and consolidated the old labor laws into a single one. The new labor law includes adjustments of the minimum wage every five years (World Bank 2012).

5.38 Naturally, complying with buyer requirements necessitates producing the right kind of product. Various interventions in the value chain support the adaption of the product to quality requirements. These interventions include garment and footwear manufacturers' own interventions and quality upgrading efforts, assistance from buyers, and interventions from the Bangladeshi government and the donors that support it. The manufacturers' own interventions include investment in technology and training of workers to meet quality requirements. Buyers constantly interact with manufacturers, particularly in the more quality-oriented parts of the value chain. For example, one garment manufacturer with its own design department worked closely with the designers of major international brands to develop styles for the export market. The close interaction allowed the brands to enjoy the benefits of relatively cheap design services in Bangladesh. It also helped the Bangladeshi manufacturer learn about export market requirements and adapt the company's production technology to market demands. Government and donors generally are not very involved in garment and footwear supply chains; however, work to upgrade Bangladeshi garments to higher-value segments is supported by industry association–run training centers, like the University of Fashion and Technology in Dhaka.

5.39 Garments and footwear exporters use a combination of first-, second-, and third-party services to ensure and demonstrate that their products meet the relevant quality requirements. First-party services include the services that exporters provide themselves. Larger manufacturers have testing laboratories and other facilities that enable them to manage quality as the product moves through the value chain. A large garment manufacturer visited, for example, tested its own produced textiles for a number of quality characteristics including color, washing, and dry cleaning color fastness; pilling; wrinkle recovery; and similar physical characteristics for which the buyer sets exacting quality standards. This garment manufacturer primarily used testing equipment from the leading U.K. manufacturer James Heal.⁵⁹ James Heal has a global network of agents, including an agent in Bangladesh, which supplies calibration services to its customers to maintain the accuracy of the testing equipment. The calibration procedures conform to International Standardization Institutions (ISO) 17025, and the calibration tools are traceable to the National Physical Laboratory in the United Kingdom.

5.40 The quality of Bangladeshi garments and footwear is continuously monitored by the international buyers who do their own testing and inspection, known as second-party services. Samples of goods are tested on arrival and large buyers even have agents in Bangladesh that may inspect facilities, with or without notice, and test the products at the end stage of production or in the production process.

⁵⁹ See http://www.james-heal.co.uk for the company website containing additional information on textile testing.

5.41 Many buyers and markets require third-party quality services, which are independent from the manufacturer, exporter, and buyer. A global industry has developed to provide such services, and the size of the Bangladeshi garment industry has attracted a large number of these providers. Present providers include Intertek,⁶⁰ Société Générale de Surveillance (SGS),⁶¹ Bureau Veritas,⁶² TÜV Rheinland,⁶³ TÜV SÜD,⁶⁴ MTS,⁶⁵ and others. They service such areas as standardization, testing, certification, accreditation, and calibration. These providers can use their global networks to create economies of scale, and thus supply services to Bangladesh that were previously unprofitable. One service provider interviewed, for example, explained that to provide certification in Good Agricultural Practice in Bangladesh, it used its Sri Lanka office, and to provide inspection services in the oil industry, it relied on its India office. When governments set import market regulations, typically to address consumer safety issues, they require third-party certification. In Bangladesh, private services for the quality industry supply such certification.

5.42 The national quality infrastructure supporting quality management in garments and footwear consists almost exclusively of private sector services supplied by a combination of domestic and foreign sources. This situation is typical for industries consisting of buyer-driven supply chains. The large international buyers dominating these supply chains manage quality by establishing a large number of private standards and codes of conduct, which in turn necessitates access to services for quality. There is particularly strong demand for private quality services in countries with large industries like Bangladesh. The Bangladeshi government supplies a very limited set of services for quality, include standards and testing, inspection, certification, accreditation, and calibration services (as explained in box 5.1). Remarkably, international buyers and the governments setting import regulations are fully satisfied with private services for quality.

Box 5.2: Lessons from Sri Lanka on Developing Garment Testing Services

The Sri Lankan garment industry procures testing services from a variety of sources. Facilities have their own testing laboratories and when independent testing is needed, the garment exporters use global service providers present in Sri Lanka, like Bureau Veritas and SGS. In the case of certain highly technical tests, exporters seek laboratory facilities available in India and Singapore.

In a project funded by the Norwegian Agency for Development Cooperation (NORAD), UNIDO has supported the establishment of garment testing capacity at the Textile Training and Support Centre (TTSC). The TTSC is a government body established in 1984 that provides training, consultancy, and testing services to the garment industry, with training as the main activity. From 1999 to 2003, UNIDO assisted the TTSC with the upgrading of its textile testing laboratory. Nevertheless, an independent evaluation published in 2010 found that, contrary to expectations, the testing laboratory lost clients after the capacity building took place.

The evaluation report analyzed the Sri Lankan demand for testing services and concluded that the lack of demand for TTSC services was caused by garment exporters' preference for private laboratories. TTSC lacked accreditation by the major international garment buyers. It also suffered from a poor service culture, exemplified by weaknesses in diligence; speed of service; and lack of ancillary services like packaging, house-to-house delivery, and mailing. The rationale for developing government-supplied testing services in a market already supplied by private service suppliers is unclear.

Source: UNIDO 2010.

⁶⁰ http://www.intertek.com/.

⁶¹ http://www.sgs.com/.

⁶² http://www.bureauveritas.com/.

⁶³ http://www.tuv.com/.

⁶⁴ http://www.tuvamerica.com/.

⁶⁵ http://www.mts.com/.

3.2.2 Ceramics

5.43 The export of ceramics is a small but growing activity in Bangladesh. Bangladeshi exports target both lower-quality segments in neighboring countries and the high-end market in high-income countries. Buyer-driven value chains dominate the high-end ceramics market and quality management in such chains bears many resemblances to garments and footwear. Bangladeshi manufacturers work with leading ceramics brands to learn about and satisfy a mixture of buyer requirements and government-mandated import regulations, using a variety of mostly privately services for quality.

5.44 Meeting high-end quality requirements necessitates the use of modern technology, the efficient operation of the technology, and the ongoing adaption and optimization of the technology. One ceramics producer interviewed had imported cutting-edge technology from Japan, allowing the manufacturing of high-quality products. The Japanese supplier provided training and technical assistance as an integrated part of the technology purchase. Details like shaping and decals are other important quality aspects in high-end ceramics and will eventually help determine market success. The producer interviewed had regular week-long visits from buyers providing advice on how to adjust the production process to meet the buyers' quality requirements.

5.45 As with garments and footwear, Bangladeshi ceramics producers use a combination of first-, second, and third-party services to ensure and demonstrate compliance with quality requirements. Leading ceramics producers have their own testing laboratories to test, for example, for color, dishwasher safety, and resistance to acids and detergents. Buyers test samples and inspect production facilities themselves. Buyers and importing country regulations may require independent third-party testing and certification. The use of private quality services is demonstrated by compliance with California State Proposition 65. Proposition 65 requires companies producing for the U.S. state of California to notify consumers about the presence of any harmful substances in their products. A high-end Bangladeshi ceramics manufacturer explained that to meet this regulation and similar ones in the EU market, no heavy metals like lead or cadmium were used in the glaze of the manufacturer's ceramics. To demonstrate that the ceramics were free of heavy metals, the manufacturer both tested its own products and procured testing services from private services providers like Ceram UK⁶⁶ and SGS Thailand. Ceram is a materials testing, analysis, and consultancy company based in the United Kingdom but operating testing laboratories around the world. Furthermore, the manufacturer was certified 9001:2008 by Netherlands department of the service provider Det Norske Veritas.⁶⁷ The same leading Bangladeshi ceramics manufacturer reported that it purchased weight calibration services from the BSTI.

5.46 The national infrastructure supporting quality management in ceramics consists almost exclusively of private sector services supplied by a combination of domestic and foreign providers. Recently, an EU-funded and UNIDO-implemented project has updated the metrology department of the BSTI, allowing ceramics manufacturers to procure weight calibration services from BSTI. Nevertheless, the ceramics industry's interaction with government quality infrastructure is overall very limited. However, the absence of government services does not prevent Bangladeshi companies from successfully targeting high-end export markets. One ceramics manufacturer felt interaction with the government quality infrastructure could be an irritant. This manufacturer had initially assisted BSTI in the development of a mandatory Bangladeshi standard for ceramics, including rules for lead- and cadmium-free glaze. Today, the manufacturer is being inspected by the BSTI every three years to achieve mandatory certification, a service for which the manufacturer paid US\$25,000 and which has no commercial value.

⁶⁶ See www.ceram.com for the company website.

⁶⁷ See www.dnv.com for the company website.

3.2.3 Fresh Produce

5.47 Airfreighted fresh produce exports constitutes a new but so far marginal source of export diversification. While other developing countries have successfully developed EU fresh produce markets (including asparagus from Peru, fresh vegetables from Kenya, and mangoes from Mali), Bangladesh faces a range of different problems including logistics, competitiveness, quality issues and problems of compliance with plant health measures. Bangladesh targets such exports to communities of ethnic Bangladeshis in the United Kingdom as well as the Middle East. The requirements for quality and plant health in these markets are considerably lower than for the rapidly growing EU supermarket trade. Although the supermarket trade puts forward exacting and demanding requirements on food safety management and intrinsic product quality, ethnic markets are more price-sensitive and demand traditional Bangladeshi products. The ethnic spot market is unable to transfer complex quality signals to the producer and consumers procuring vegetables through the market are unwilling to pay for supermarket quality characteristics. EU-bound exports must nevertheless still satisfy EU regulations on food safety and plant health. EU plant health rules have challenged Bangladesh. The Plant Protection Wing of the Ministry of Agriculture, the national Bangladeshi plant health authority, reports that it has received many notifications from the EU concerning harmful pests detected on U.K.-bound citrus exports. In collaboration, the citrus producers and the Plant Protection Wing have developed the Bangladeshi plant health system with the aim of meeting the plant health requirements of the EU. Such problems are typical for the extremely stringent EU market. By contrast, the Plant Protection Wing has not received any complaints on food safety or plant health problems from markets in the Middle East, Bangladesh's largest market for airfreighted fresh produce.

5.48 Even when receiving apparently similar products, like vegetables for Bangladeshi ethnic communities, the EU and Middle East have very different standards for food safety and plant health. Successful Bangladeshi exporters carefully target export markets demanding quality characteristics they can comply with. This strategy is one way of coping with the quality challenge: rather than adapting the product to the market, the exporter selects the right market for the product. In the longer term, breaking into larger-volume trading segments in the EU like the supermarket trade would require very considerable upgrading of the Bangladeshi supply chain. Bangladesh faces a host of challenges in this regard, only some of which are related to quality. Given the country's geographical location and the intense competitive in the EU outside ethnic markets, even if quality is raised significantly and EU private and public food safety and plant health requirements can be met.

5.49 Contrary to garments, footwear, and ceramics, the challenge for airfreighted Bangladeshi produce is primarily related to government regulations. Private quality requirements for the market segment currently targeted by Bangladeshi exporters are relatively lax. The EU, however, has intercepted banned pests like the citrus canker and exotic fruit flies in plant consignments from Bangladesh (FVO 2010). An EU inspection of the Bangladeshi plant health system in 2010 concluded that:

The organisms of concern to the EU, in particular citrus canker and citrus blackspot, are known to occur in Bangladesh and no pest free areas have been established for these.

Action has been taken in response to the continued EU interceptions of harmful organisms on fruit and vegetables exported from Bangladesh, however the lack of traceability and use of exporter declarations, combined with the limited awareness of EU import requirements and harmful organisms of concern, and very limited laboratory and technical support for the NPPO and records of activities, means that the current system of official export checks does not ensure compliance with EU import requirements, and until the shortcomings identified are corrected, there will be a continued risk of introduction of harmful organisms to the EU. This is

particularly so for *Xanthamonas axonopodis* and *Guignardia citricarpa*, on citrus fruits (FVO 2010, p. I).

5.50 The national infrastructure supporting quality management for airfreighted fresh produce exports is weak. The private service industry that serves garments, footwear, and ceramics exports well has found no clients able to pay for services in fresh produce. This is primarily due to the small size of the sector and also reflects the many small farmers and SMEs in the supply chain. The EU's FVO report demanded significant changes to government quality infrastructure. The demands included upgrading the system of issuing plant health certificates; investment in government equipment and facilities necessary to carry out inspection, testing, consignment verification, plant health certification, and heat treatment of wood packaging materials; and training of officials responsible for export checks. In the future, such upgrading of the government quality infrastructure is inevitable, but it is debatable whether the demands of the tiny fresh produce industry would by themselves justify new investments at this point. The fresh produce industry already suffers from many hurdles to becoming competitive in the EU market. Prematurely upgrading quality infrastructure will not increase exports, as other problems are likely more constraining. Such problems include long and uncoordinated supply chains and higher airfreight rates and longer flights for Bangladesh than for competitor regions like North and Eastern Africa and the Middle East. Therefore, if the Bangladeshi government wishes to upgrade the phytosanitary management component of the quality infrastructure like, it should target the domestic and regional markets before looking at the demands of far-away markets.

3.2.4 Seafood

5.51 Seafood exports, in particular frozen shrimp, are a growing source of export diversification, but success has been hampered by inconsistent quality. Bangladeshi seafood is primarily exported to the EU and the United States, where food safety regulation is tight. EU regulations are generally seen as the most stringent ones. To be allowed to export seafood to the EU, a country needs a seafood safety regime deemed equivalent to the EU system. Additional requirements like the establishment of a national residue control system apply too. The EU has approved the Bangladesh the Department of Fisheries as a national Competent Authority to monitor the Bangladesh industry and approve individual processing facilities for export to the EU. The EU regularly inspects the regulatory system and the industry. In addition, the EU monitors seafood safety at points of import. If violations are detected either during country inspections or at the point of import, the EU demands corrective actions and may impose additional requirements in case of grave violations of its food safety policy (European Commission n.d.).

5.52 The EU has frequently imposed additional requirements for Bangladeshi seafood. In 1997, the EU banned imports of Bangladeshi seafood following EU inspections of Bangladeshi processing plants. Inspections found deficiencies in the infrastructure and hygiene of the plants and insufficient government quality controls (Cato and Subasinge 2003). The ban sparked more investment in processing plants and government regulatory capacity by industry, government, and donors. Subsequent EU inspections determined that six processing plans met EU requirements and lifted the ban for these six plants by the end of 1997. In the following years, the upgrading of the Bangladeshi industry continued and by 2002 65 plants held Bangladeshi government licenses for exports, of which 48 plants had EU approval. However, frequent inspections by the EU since 2002 have pointed out additional problems. The EU Rapid Alert System for Food and Feed has regularly reported interception of Bangladeshi consignments with food safety problems like banned antibiotics and microbiological contamination. As late as November 2011, the EU lifted a requirement for 20 percent mandatory testing of Bangladeshi seafood due to progress made in the Bangladeshi residue monitoring system.

5.53 Contrary to garments, footwear, and ceramics, compliance with quality requirements in seafood is essentially about meeting government-set regulations. The organization of the industry is radically different from light manufacturing industries. The value chain of the most important product, frozen shrimp, is long and dominated by small farms linked to exports by middlemen. Respect of food safety

regulation requires action from a large number of small operators, including shrimp fry hatcheries, small farmers, processors, and input providers like the suppliers of feed and animal medicine. The uncoordinated nature of shrimp value chains coupled with import market regulations has created a strong demand for government involvement and private industry coordination. In Bangladesh, the Department of Fisheries regulates the seafood value chains. Import market food safety rules are complex and continuously evolving and seafood operators from primary producers to processors as well as Bangladeshi government officials have struggled to understand the regulations and keep up with the changes. Information about the applicable regulations flows from the EU and donor technical assistance projects as well as the Department of Fisheries to value chain participants.

5.54 Adapting Bangladeshi seafood to high-paying import market requirements necessitates completely new production and processing methods. Bangladesh traditionally produces and consumes seafood in large quantities, but past experiences in the Bangladesh market provide poor guidance for export market success. Seafood is highly perishable and prone to food safety hazards. Import markets are far away and require quality characteristics that traditionally have been of no value in the domestic market. Successful domestic producers trying to base export production on their domestic experiences will eventually fail. To adapt Bangladeshi seafood to the new quality requirements, industry, government, and donors are undertaking a number of supply chain interventions. Individual processors have updated their plants and developed links with downstream suppliers. The Bangladesh Frozen Food Exporters Association organizes processors and advises government and its members on quality management. The Department of Fisheries has overall responsible for regulatory oversight and inspection. Donors, acting through Bangladeshi government departments, notably the Department of Fisheries, have provided strong support to the seafood sector. For example the USAID-funded project called Poverty Reduction by Increasing Competitiveness of Enterprises (PRICE) has contracted the World Fish Centre to implement the Greater Harvest and Economic Returns from Shrimp (GHERS) initiative; GHERS is focused on piloting greater integration in the value chain to increase productivity and quality. Under GHERS, shrimp depot owners work with hatcheries to ensure the supply of disease-free shrimp fry to farmers, thereby reducing future demand for antibiotics and subsequently reducing the risk of exported shrimp being rejected in the EU and elsewhere due to antibiotic residues. The GHERS initiative builds upon the experiences of two previous USAID projects, namely the Shrimp Seal of Quality Project and the Shrimp Quality Support Project (World Fish Centre 2011). The Better Work and Standards-Better Fisheries Ouality (BEST-BFO) program is funded by the EU, NORAD, and the government of Bangladesh and implemented by UNIDO. The program is a follow up to the Bangladesh Quality Support Program implemented during 2006-10. BEST-BFQ applies a "farm to fork" approach that focuses on strengthening the national fisheries quality infrastructure of Bangladesh. BEST-BFO supports value chain by upgrading through training farmers in good aquacultural practice, and by training processors and other value chain participants on traceability and the hazard analysis and critical control points (HACCP) approach. A number of other donor projects support the upgrading of the Bangladeshi seafood industry.

5.55 Seafood exports primarily use Bangladeshi government services to demonstrate compliance with the stringent export market regulatory requirements. Compliance necessitates regulatory oversight and intense monitoring and testing, which, according to Bangladeshi law and in compliance with EU rules, must be provided by the Department of Fisheries. EU regulations are extensive and very stringent. Imports of seafood into the EU are subject to official certification. The certification is supplied by Department of Fisheries, recognized as the Competent Authority by the EU. As the Competent Authority, the Department of Fisheries ensures inspection and control throughout the value chain. It monitors all relevant aspects of hygiene, public health, and, in the case of aquaculture products like frozen shrimp, animal health. Live aquatic animals, their eggs, and fry must fulfill animal health standards, which requires veterinary services to enforce health controls and monitoring programs. The Department of Fisheries must also guarantee compliance with hygiene and public health requirements, including rules on the structure of vessels, landing sites, and processing plants, as well as rules on processing, freezing, and storage. A control plan on heavy metals, contaminants, and residues of pesticides, and veterinary drugs must be in place for aquacultural products like frozen shrimp. Only approved vessels and establishments, inspected by the Department of Fisheries and found to meet EU requirements, may export to the EU. As the Competent Authority, the Department of Fisheries regularly inspects approved vessels and establishments and guarantees the respect of EU rules. Inspections by the EU's Food and Veterinary Office confirm Bangladesh's compliance with EU requirements. Finally, Bangladeshi seafood consignments are subject to border inspections where each consignment is subject to a documentary check, identity check, and, as appropriate, a physical check. The frequency of physical checks depends on the risk profile of the product and the results of previous checks.

5.56 The Bangladeshi government and supporting donors have invested many resources in the establishment of a seafood quality infrastructure that meets the demand of the major export markets. This development has been entirely focused on government services. The capabilities of private quality services that work for other export industries like garments, footwear, and ceramics have not been developed. Other countries in the region use a different approach. In Indonesia, the Competent Authority allows private laboratories to conduct testing for monitoring programs, while using its own laboratory for the testing needed to issue health certificates. In Thailand, testing for monitoring and for the issue of health certificates may both be undertaken by private laboratories.

5.57 The Department of Fisheries should consider allowing a private market for seafood quality assessment. International best practice demonstrates that quality assessment services can be efficiently provided by the private sector. For example, current Bangladeshi law dictates that testing for nitrofurans, chloramphenicol, and similar substances must be done at a government laboratory. A leading private quality services provider interviewed stated that while the company currently had no capacity to test for such substances, a change in the law would, in its view, create a sufficiently large market to warrant investing in laboratory facilities to service the seafood export industry. This company has already undertaken physical inspection for shrimp exporters and certified seafood processing plants against HACCP, another mandatory EU requirement.

3.3 Summing Up: Sources of Supply of Services for Quality

5.58 The private provision of services is an integral part of Bangladesh's quality infrastructure. Private providers supply services relating to standardization, testing, certification, accreditation, and calibration. Bangladesh has a thriving private market for quality services. In light manufacturing exports, international service providers with an office in Bangladesh, like Intertek, SGS, Bureau Veritas, TUV Rheinland, TUV SUD, MTS, and others, supply conformity assessment services. A conformity assessment need that cannot be satisfied by suppliers based in Bangladesh is often supplied through trade. Bangladesh benefits from its proximity to service providers serving larger and more mature markets, like India and Thailand, but also Malaysia, Singapore, and Sri Lanka. The presence of a large variety of service providers in the region is an advantage that Bangladesh can exploit while gradually building the national quality system. Initially, Bangladesh may wish to focus on a few high-priority areas while supplementing its own limited range of services with imports. Eventually, the amount and diversity of services offered in Bangladesh will be much increased; however, even advanced economies like those in the EU trade intensively in services for quality. An efficient national quality system would continue to exploit the gains from imports as it matured.

5.59 The present import of services India's National Accreditation Board for Testing and Calibration Laboratories (NABL) exemplifies the gains from trade in services for quality. From its base in New Delhi, NABL has served both the BSTI and SGS with services. While attempts to establish a national accreditation board in Bangladesh have proven difficult, the sourcing of Indian services has allowed BSTI to acquire accreditation for a part of its laboratory capabilities and to continue working toward achieving accreditation for the rest. Meanwhile, SGS has imported metrology services from NABL. In this way, Bangladesh has saved resources otherwise needed for the development of national accreditation and

metrology supplies—resources that may be used to develop other and higher-prioritized parts of a national quality system.

5.60 Whether the private service providers cover the needs of SMEs is questionable. The services of international service providers tend to be costly. SMEs, especially those operating in small sectors poorly covered by private providers, may be constrained to operate in market segments in which the demand for services for quality is low or where this demand may be met by their international buyers. Knowledge of the demand for services for quality by SMEs is limited. Potentially, the needs of SMEs are covered by working with larger operators, which are in a better position to provide quality management.

5.61 Government provision of services for quality is minimal. Although a range of government institutions is theoretically in position to provide services, very few services are indeed provided. In light manufacturing industries, none of the private sector operators interviewed expressed any desire to use government services for vital tasks, but preferred to rely on private services for quality. BSTI and a range of laboratories in various parts of the government and in universities could in theory provide conformity assessment services, like testing and certification. However, the poor quality of most of the laboratories and the lack of a business-oriented service mentality severely limits the provision (Raj Sud 2010).

5.62 The situation is different in the seafood industry because the governments of high-income import markets require the Bangladeshi government—represented by the Department of Fisheries—to safeguard quality. In the case of seafood exported to the EU, the EU requires that the Department of Fisheries act as a Competent Authority, with legal powers and resources to ensure credible inspection and controls throughout the value chain. Therefore, the Department of Fisheries must be competent in matters of hygiene, public health, and, for farmed shrimp, animal health, and must be able to provide services for quality like testing and certification. Given the importing market requirements, both the efforts of the Department of Fisheries and of the private sector operators have been crucial to the seafood industry's export success.

5.63 BSTI acts like a regulatory agency rather than a service provider. BSTI primarily provides testing and certification against its own mandatory standards, most of which cover both domestic and imported products. These mandatory standards have no value to export industries (Raj Sud 2010). BSTI has attempted to set up some services in areas of interest to export industries. However, the rationale behind these attempts is unclear. Exemplified by investments in a textile laboratory, these attempts risk unnecessarily duplicating already successful provisions of such services by the private sector. The only part of BSTI that does provide some level of services is the metrology department, supported by the EU-funded and UNIDO-implemented project BEST-BQI. BSTI mainly impacts Bangladeshi trade by mandating standards and associated inspection and testing. Thus, BSTI is further discussed in the next section that focuses on import regulation.

4 Meeting the Quality Challenge at Home: How Bangladesh Manages Import Procedures

4.1 Quality Requirements for Imports into Bangladesh

5.64 A large number of Bangladeshi quality-related laws, regulations and SPS measures influences trade and disturbs the free flow of imports unnecessarily. Imports need to flow smoothly both to support the import needs of the export sectors and the needs of the domestic population. The problematic laws and regulations may be divided into three broad groups. The first group consists of technical regulations, in Bangladesh known as mandatory standards, on a range of products including food and agricultural products, chemical products, textiles, electrical and electronic products, and engineering products. The second group consists of SPS measures, notably food safety laws and regulations and plant health laws and regulations. The third group includes a number of "special rules" stated in the Import Policy Order (Ministry of Commerce 2010).

5.65 Mandatory standards require inspection and testing at the border. BSTI under the Ministry of Industries coordinates and heads a system of technical committees that draft Bangladeshi standards. The committees have some private sector participation, although not to the same degree as observed in countries with a strong history of standards development. While the standards are voluntary in principle, around 150 products have currently been brought under the Mandatory Certification Marks Scheme and are therefore mandatory. The Ministry of Industries has the power to make standards mandatory, often acting on the recommendation of BSTI. Currently, 64 food and agricultural products, 39 chemical products, 11 textile products, 25 electrical and electronic products, and 14 engineering products are under the border and testing is undertaken if the present BSTI inspector esteems it necessary. According to BSTI, a total of 65 inspectors are available for both ensuring the compliance with the mandatory standards for imported and domestically produced products and for voluntary certification. BSTI reports that all consignments are inspected and no risk profiling is used to prioritize the burden of conformity assessment.

5.66 Exporters to Bangladesh meet a range of quality-related demands at the border. Bangladesh is a net food importer. In the financial year of 2008/09, about 5.63 metric tons of food, including rice, wheat, pulses, sugar, edible oil, and onions, were imported, representing a value of US\$1.9 billion. About 80 percent of all imported food enters the country through the Chittagong seaport and Benapole land port (FAO 2010a). Bangladeshi food safety standards are set by BSTI, which generally seeks to base them on the international Codex Alimentarius⁶⁹ standards. BSTI itself focus on the implementation of the mandatory food standards for which it is responsible. In general, food inspection in Bangladesh is rather complicated and involves multiple ministries and agencies. Fifteen ministries are involved in food safety and quality control and ten ministries are directly involved in food inspection and enforcement services. The roles and responsibilities of the concerned ministries and agencies are unclear. The overall coordination body for food safety and food control at the national level is the National Food Safety Advisory Council (FAO 2010a).

The Department of Customs, working in close collaboration with port authorities, is responsible 5.67 for border food inspection. Inspection is carried out as prescribed by the Import Policy Order as well as a number of subsidiary acts and standards. All food imports are inspected without adherence to any clear procedures, protocols, or guidelines (FAO 2010a). Preshipment inspection was mandatory for products imported to Bangladesh until June 2013. Shipping documents must include radioactivity test reports and certificates declaring "fit for human consumption," "not mixed with harmful substances," and country of origin. Meat imported from EU countries must be certified as free from Mad Cow disease. As part of the document verification process, customs authorities carry out physical tests, including organoleptic tests, at the port. According to a report from the Food and Agricultural Organization of the United Nations (FAO), imported food samples may be analyzed by laboratories at BSTI, the Bangladesh Atomic Energy Commission, the Plant Protection Wing, the Department of Agricultural Extension, the Fish Inspection and Quality Control Wing of the Department of Fisheries, the Bangladesh Council of Scientific and Industrial Research, and the Customs Department laboratory in Chittagong (FAO 2010a). The requirement for radioactivity tests is reported not to be strictly implemented on food products originating from countries from the South Asian Association for Regional Cooperation (SAARC) and the Association of Southeast Asian Nations (ASEAN). The BSTI laboratory only analyzes products for which mandatory BSTI standards exist. Products not complying with Bangladesh rules may be labeled correctly, downgraded to purposes other than human consumption, destroyed, or returned to the country of origin,

⁶⁸ See http://www.bsti.gov.bd/list.html for a full list of the products under the Mandatory Certification Marks Scheme.

⁶⁹ http://www.codexalimentarius.org/.

depending on the nature of the problem. Customs do not keep information on the compliance history of importers, effectively making risk profiling impossible.

5.68 Domestically, the food safety regime is very weak. A 2010 FAO report reviewing Bangladesh's food safety and quality policies argues that "[w]hile a range of national policies and other documents make some reference to aspects of food safety and quality in Bangladesh, there is only limited focus on food safety and important issues are dealt with only superficially" (FAO 2010b). Historically, Bangladesh food policy has focused on food security because of the country's tragic past experiences with famine catastrophes.

5.69 Potential exporters to Bangladesh encounter uncertainty about the prevailing plant health regime. All exporters need a phytosanitary certification to export plants and plant products to Bangladesh. According to the Bangladeshi authority for plant health, the Plant Protection Wing of the Ministry of Agriculture, there are 26 quarantine stations at the border: 20 at land borders, 3 in airports, 2 in sea ports, and 1 in a river port. Each quarantine station has a staff of 68 people, except Chittagong, which has a staff of 14. In total, 190 people work in quarantine. The import procedure is the following:

- The exporter gets a phytosanitary certificate from the authorities of the exporting country.
- The Plant Protection Wing issues an import permit, either centrally in Dhaka or at the border.
- When the product arrives at a border post, Plant Protection Wing personnel check the documentation and inspect the product for plant health problems.
- If the Plant Protection Wing observes a problem, they take samples and test in a laboratory. They have 10 plant quarantine labs at border posts. If they observe insects, they send samples to a laboratory in Dhaka.

5.70 According to the Plant Protection Wing, transaction times are typically low, one to two hours if documents are satisfactory and inspection does not find any problems. If testing is needed, up to three days may be needed to finalize the transaction. In the case of seeds, the transaction time may exceed three days.

5.71 The Import Policy Order includes a number of special import regulations that address quality issues. The Order stipulates that imports must be accompanied by certificates for absence of melamine for the import of milk and milk products; by certificates for radioactivity (presence of CS-137), required for many products and origins, issued both by the exporting country and by the Bangladesh Atomic Energy Commission; and certificates for the "purity" of oil palm products (including palm oil, palm olein, and RBD palm stearin). The scientific basis for such requirements is not obvious. In general, for many Bangladeshi import requirements, neither the process through which they are adopted nor the form in which they are published meet international best practice. While the import requirements often, at least in principle, target legitimate needs, like food safety, they are formulated in a way that offers little protection but inflicts costs unnecessarily on the private sector and the consumer.

4.2 Import Regulation Agencies in Bangladesh

4.2.1 Bangladesh Standards and Testing Institute

5.72 BSTI is simultaneously the Bangladesh national standardization body (a regulatory agency) and a supplier of conformity assessment services. BSTI coordinates and heads a system of technical committees that draft voluntary Bangladeshi standards. The system consists of a mixture of government, academia, and private sector representatives. At the same time, BSTI is involved in the process of setting mandatory standards (that is, technical regulations) by advising the Ministry of Industry, which ultimately adopts mandatory standards. In most cases, the Ministry of Industry follows the advice of BSTI. Finally, BSTI provides testing, inspection, and certification against "Quality Marks" for products under mandatory certification.

5.73 Two EU-funded and UNIDO-implemented projects have recently provided assistance to BSTI. The Bangladesh Quality Support Program (BQSP) provided support in 2006–10 while the Better Work and Standards—Better Quality Infrastructure (BEST-BQI) program continued support right after termination of BQSP and will end in 2014. BSTI is implementing or planning a number of other projects that are supported by a mix of government and donor funding; these are presented in Appendix B. As evidenced in project documentation from the BQSP and the BEST-BQI projects, strong disagreements exist between quality infrastructure actors in Bangladesh about the functioning of BSTI (Raj Sud 2010). The disagreements focus on conflicts of interest inherent in BSTI as a result of its many responsibilities. A baseline study report concludes that:

The conflict between regulatory functions and government's role in providing a national standards, conformity assessment, measurements infrastructure to support trade and industry was noted to be a central concern within BSTI as reported by several BWSP consultants. BSTI, the main national agency that provides conformity assessment, standards and calibration services is ineffective in providing services to exporters or industry due to its focus on regulatory functions such as mandatory standards enforcement and weights and measures enforcement. It remains ill equipped to serve industry due to non-availability of human resources for functions that service industry, poor management practices and a certain lack of credibility and recognition of the reports issued (Raj Sud 2010, p. 2).

5.74 A survey of BSTI clients in various sectors conducted in September 2010 revealed a high degree of dissatisfaction with BSTI services. The survey covered the four major services delivered by BSTI—product certification, testing, calibration, and standards development. The survey collected 217 responses from randomly selected respondents among BSTI's clients and standards committee members. Fifty-eight percent of the respondents were large firms (more than 500 employees), and the rest were small firms (less than 500 employees). Table 5.2 presents the survey results. Overall, 41 percent of the respondents were dissatisfied with the services of BSTI. Respondents indicated a number of reasons for their dissatisfaction, including slow service, unreasonable requirements, no benefits provided (from mandatory certification), and lack of credibility (from testing services). Especially, respondents were dissatisfied with mandatory certification (Raj Sud 2010).

	Satisfied	Dissatisfied	Neither satisfied or dissatisfied
Certification marking	29	71	0
Calibration	50	47	3
Testing	31	26	52
Standards purchasers	81	19	0
Average	48	41	11

Table 5.2: BSTI Client Satisfaction (percent)

Source: Raj Sud 2010.

5.75 To increase its effectiveness and efficiency, BSTI could draw on lessons from international best practice in technical regulation and standardization in three areas: use of mandatory standards, avoiding conflicts of interest, and standards development. Mandatory standards, which are known internationally as technical regulations, should only be used when core regulatory objectives are at stake. Such objectives vary by country, yet typically include issues like consumer safety, environmental protection, and compatibility issues. The list of mandatory standards applied in Bangladesh gives the impression that no clear guidelines are followed when determining whether a particular standard should be voluntary or not.

The products and issues regulated by mandatory standards appear to be chosen somewhat randomly. A small, randomly chosen sample of BSTI mandatory standards reveal the lack of adherence to international best practice. While interviewing BSTI officials, the consultant was given copies of the BSTI mandatory standard for yoghurt entitled "BDS CAC-A-11 (a): 2002 for yoghurt and sweetened yoghurt." The yoghurt standard regulates fat content, milk solids, which bacteria cultures to add, and similar issues with no direct implications for food safety or other regulatory objectives normally considered legitimate. Hygiene issues like bacterial counts are curiously absent. The yoghurt standard appears to be a trade standard—that is, a standard defining the nature of the products. Such standards are typically voluntary. Surprisingly, common food safety issues regulated in technical regulations for yoghurt in many countries are not addressed by the Bangladeshi standard. By restricting the use of mandatory standards to issues seen as legitimate in other countries, the Bangladeshi government would achieve more efficient regulation. This would allow the private sector to set quality characteristics according to market needs for issues considered suitable for market determination. At the same time, more efficient regulation would economize on the government's enforcement resources, and provide more effective regulation of legitimate issues like consumer protection.

5.76 It is international best practice to separate regulatory powers (such as setting mandatory standards) and conformity assessment (such as testing, inspection, and certification). In contrast, BSTI strongly influences the adoption and formulation of mandatory standards while simultaneously benefitting from the incomes from testing, inspection, and certification against these mandatory standards. In OECD countries, it is highly unusual to give NSB regulatory functions. In some countries, the NSB is merely a standards developer, while in others; it has departments involved in the provision of conformity assessment services. Regulation is the domain of other agencies, typically government ministries. In Bangladesh, the Ministry of Industry has delegated the functions of standardization, quality, certification, technical regulation, and metrology to BSTI. Accreditation is the responsibility of the Bangladesh Accreditation Board, which functions as a department under the Ministry. BSTI is the regulatory agency responsible for the implementation of mandatory standards, the Pure Food Rules, and import consignment approval for 39 items. The BSTI Certification Wing undertakes these functions. In 2010, 15 officers were responsible for implementing product certification for approximately 14,500 licenses. These officers processed 10–15 new applications per day, participated in mobile courts for prosecuting offenders, approved imported consignments, and implemented the Pure Food Rules (Raj Sud 2010). Mandatory standards are approved by the Ministry of Industries, usually following BSTI recommendations. The combined provision of standards development responsibilities, regulatory functions, and conformity assessment services damages the credibility of BSTI. The current structures do not meet international best practice to ensure independence and impartiality.

5.77 Standards development in BSTI suffers from poor quality nonpublication of a large portion of approved standards, and noncompliance with the WTO/TBT Code for Standards, according to UNIDO's baseline study report (Raj Sud 2010). Of 3,300 adopted standards, 1,000 have remained unpublished for years. The Standards Law focuses on mandatory standards but not on the economic and social benefits of a well-functioning system of voluntary standardization. The two UNIDO projects, BQSP and BEST-BQI, have worked to increase the quality of BSTI standards development:

A quality manual and procedures were developed during the BQSP interventions. A small portion of these has been implemented. These require review and formal implementation. The current process and practices for standards development do not fully comply with ISO Guide 59 and the WTO/TBT Code for Standards. BSTI has established a functioning committee structure for standards development. The membership of the committees and rules for operation require review to assure consensus process is followed and wider stakeholder participation. There is a corresponding concern with the quality and relevance of many existing BDS standards due to obsolete content and errors.

BSTI does not provide information services or undertake any promotional activities on standards for trade and industry. The awareness of the utility and benefits of standards is low with many officials equating standards with technical regulation. It has developed some capacity to participate in international standards during BQSP, but participation mostly remains on observation basis for limited sectors (Raj Sud 2010, p. 13).

5.78 The Bangladesh Accreditation Board is being upgraded with assistance from a UNIDO-led technical assistance project. The Bangladesh Accreditation Board was established by an Act of the Parliament in 2006 (Act No. 29, 16 July 2006) as the national accreditation authority. The Board currently functions as a department of the Ministry of Industry (Raj Sud 2010). The vision of the Bangladesh Accreditation Board is to improve national capacity in testing and measurement, thereby assisting the overall development of Bangladesh by strengthening production capability, competition, consumer protection, and trade facilitation. As discussed above, BEST-BQI is a program funded by the EU, NORAD, and the government of Bangladesh and implemented by UNIDO; it is a follow-up to BQSP, implemented during 2006–10. BEST-BQI seeks to make the Bangladesh Accreditation Board an internationally recognized accreditation body. International recognition necessitates that the Board becomes a full member of the International Laboratory Accreditation Cooperation (ILAC) and the International Accreditation Forum (IAF). Today, the Board is only an affiliate member of ILAC and plans to seek IAF membership.

5.79 UNIDO activities aim at building capacity in laboratory accreditation. UNIDO's opinion is that the demand for inspection body and certification body accreditation is too small to justify developing capacity in these areas (Raj Sud 2010). BEST-BQI currently works to accredit a number of Bangladeshi public and private laboratories. This accreditation will be granted by a foreign entity, which will work with the Bangladesh Accreditation Board to build its capacity in laboratory accreditation. This current UNIDO activity builds on assistance provided under BQSP, where 15 laboratories—many of them seafood laboratories—received assistance for accreditation.

5.80 International accreditation bodies already operate in Bangladesh and will in the future compete with the Bangladesh Accreditation Board. For example, NABL (India), UKAS (United Kingdom), and RvA (Netherlands) have accredited private test laboratories of SGS, Bureau Veritas, and Intertek (Raj Sud 2010). These international bodies primarily service the garment industry and similar export-oriented light manufacturing industries. Competing with these international bodies will be a severe challenge for the Bangladesh Accreditation Body. Foreign buyers only appoint laboratories, inspection services, and management system certifiers accredited by known and trustworthy accreditation bodies. The Bangladesh Accreditation Board is yet far from achieving the level of credibility of its international competitors.

4.2.2 The Plant Protection Wing

5.81 In 2011, the new Plant Protection Act was enacted, which largely expands the regulatory scope of the Plant Protection Wing. However, it lacks the capacity to implement the additional responsibilities. Therefore, the Plant Protection Wing still instructs its personnel to act according to the old rules. The current procedures are based on the 1940 rules as amended in 1985. The Plant Protection Wing has not developed a plan for transitioning from the old to the new regulatory framework. It is to be expected that a gradual transition will take place over many years. Exporters will face difficulties in understanding which requirements to follow, as the regulations implemented will deviate substantially and likely unpredictably from the ones in the 2011 Plant Protection Act.

5 Meeting the Quality Challenge Next Door: Regional Trade and Quality

5.82 The bilateral trade balance between India and Bangladesh reveals that India exports much more to Bangladesh than vice versa. While this may be the result of Bangladesh's specialization in light

manufacturing exports for more distant markets, suspicions run deep that nontariff barriers (NTBs) on the Indian side severely hamper Bangladeshi export opportunities. Bangladeshi media frequently report on such NTBs and one area suspected to give rise to barriers is technical regulations and standards. In particular, one company interviewed expressed deep concerns over the complicated SPS measures met when exporting processed food to India. The story is that the Indian authorities demand excessive testing on the Indian side. The company's processed food is subject to mandatory Bangladeshi standards, and thus is already tested and approved by the BSTI. Indian authorities merely repeat these tests. The company interviewed states that India requires laboratory testing from their Central Food Laboratory prior to issuing sales permissions. Central Food Laboratory testing is required for each product of every consignment. In Northeast India, the Central Food Laboratory is located in Guwahati of Assam state. It takes 45 days to get the Health Report from the Public Health Analyst office of Guwahati, which is located 300–600 kilometers from border crossings. In the meantime, products are kept in a bonded warehouse at the port area. Ultimately, the products reach the Indian market with nearly two months delay.

5.83 This trade dispute might be addressed by the conclusion of a mutual recognition agreement (MRA). An MRA states that technical regulations, standards, and conformity assessment procedures undertaken on one side of the border are essentially equal to the ones undertaken on the other side. Thus, goods produced in one country can be freely marketed in the other. MRAs facilitate trade by enabling manufacturers to have their products tested and certified in the country of origin, for compliance with the regulatory requirements of the importing country. By eliminating the time delays and costs associated with obtaining regulatory approval in the importing country, MRAs benefit the parties' businesses by delivering significant savings in time and money. Under MRAs, one government agrees to recognize the results of another's testing, inspection, SPS certification, or other procedures. Therefore, the manufacturer can meet both parties' standards by undergoing one inspection, testing, or certification procedure by approved bodies in whichever country is most convenient. For example, mutual recognition may apply to all foods traded between countries that are parties to an agreement or only to specified foods. Similarly, recognition may apply to all requirements applicable to specified foods (including food standards) or only some (such as conformity assessment procedures). Countries may elect to enter into an umbrella agreement consisting of general provisions and specific sectoral arrangements made under the umbrella agreement.

5.84 The feasibility of establishing mutual recognition will be greatest between countries that have broadly similar attitudes to the appropriate level of protection against health risks and deception of consumers, and between countries that have broadly similar capabilities for monitoring and enforcement of requirements. Often, such countries will be neighbors with a long tradition of trading food and other SPS-regulated products. For example, MRA initiatives within ASEAN and APEC are a clear testimony to the validity and commercial attractiveness of such approach.

5.85 The negotiation and conclusion of equivalency agreements and MRAs is often costly and timeconsuming. An MRA requires a thorough evaluation of a number of factors. Economic considerations are one factor (for example, the level of trade in the product concerned, prioritization, availability of relevant statistics, tangible benefits accruing from the conclusion of such agreements, and so forth). Other considerations include the compatibility between regulatory systems, the impact on domestic regulatory systems, the regulatory challenges imposed by the negotiation, the costs assessment and time forecast of the negotiating process, the availability of resources, and domestic support. Negotiations are lengthy as they involve a number of steps, including the process of documentary review and comparison. Problems may also arise as a consequence of different legal structures, from difficulties in identifying a single authority for overall control of the system (especially where more than one regulatory body is involved), and from a counterpart's relative lack of willingness and readiness to negotiate. In addition, such negotiations often require the commitment of technical and trade specialists to review materials. 5.86 Recent media reports have claimed that India will accept the certification of BSTI, thus expediting exports by avoiding testing on the Indian side of the border (Daily Star 2012b). This development should be the result of Indian institutions accrediting BSTI product certification (Daily Star 2012a). But a major Bangladeshi exporter of processed foods to India states that although accreditation has been granted to some but not all BSTI tests, no formal agreement has been signed to accept BSTI's certification. Therefore, India continues to test Bangladeshi products on the Indian side of the border.

5.87 Solving frequent complains about Indian NTBs may require deep institutional reforms of the Bangladeshi system of standardization and inspection. Ideally, Bangladesh should negotiate an MRA or pursue equivalence of the relevant SPS measures with India. However, in reality, the successful completion of an agreement with India may require much more work than commonly believed in Bangladesh. The current Bangladeshi is subject to criticism because of its very large agenda, limited resources for enforcement, and strong conflicts of interests within BSTI (the main regulatory agency). The Indian authorities may argue convincingly that the guarantees of product safety offered by the Bangladeshi system are not convincing. The Bangladeshi authorities could greatly improve the odds of an MRA with India if they aligned the present certification system more closely with international best practice.

5.88 To start negotiation of mutual recognition, donors could fund a road map of mutual recognition of food-related border procedures. The elements of this road map are:

- Examine the concurrent Indian and Bangladeshi legislation.
- Assess the standards and conformity assessment procedures applied.
- Promote mutual trust and bilateral cooperation in food production and trade.
- Work toward mutually recognizing the critical elements of each other's regulations.
- Hold technical discussions about the necessary steps for achieving mutual recognition.
- Identify and support necessary reforms.
- Establish regular contacts and communication concerning standards, technical regulations (mandatory standards), and conformity assessments in the Indian-Bangladesh border trade.

6 Conclusions and Recommendations

5.89 The government and the donors need to be pragmatic when assessing Bangladesh's efforts in quality management and realistic about the opportunities for the rapid upgrading of government capacities. In most least developed countries, the general picture of both the public and private sectors is one of very limited quality management capacity. This emphasizes the need for prioritization. While most developed countries possess extensive national quality infrastructure, both resource constraints and genuine economic needs dictate that developing countries develop their quality infrastructure step by step. In that regard, government and donors should recognize that the private sector and the government play complimentary roles in quality management. In the buyer-driven value chains to which Bangladesh caters, standard setting, testing, certification, and even the provision of metrology services are dominated by private service providers. This characteristic should not be seen as a threat to the existing government quality infrastructure, but as an opportunity allowing the government to build capacity in the most crucial areas first, while ensuring that exporter demand for quality management is met.

5.90 Bangladeshi quality management may be improved through a variety of means. These include value chain interventions, ensuring the supply of services for quality, and promoting the smooth flow of imports while respecting legitimate needs for import regulation like food safety. Potentially fruitful areas for reform of the existing quality infrastructure in Bangladesh include the following:

- Consider opportunities to open fishery testing markets for private sector service providers.
- Review the new Plant Protection Act and develop an implementation plan that provides clarity to importers about the prevailing rules. At the same time, meet the regulatory needs of Bangladesh.

- Introduce international best practice among border management agencies. These practices include developing the use of risk profiling and similar modern techniques to increase regulatory effectiveness while facilitating trade.
- Review the list of mandatory standards to determine whether they meet legitimate regulatory objectives and can be effectively enforced.
- Continue ongoing work by UNIDO to reform BSTI, with the aim of bringing the BSTI structure into closer alignment with international best practice and avoiding conflicts of interest.
- Develop a mutual recognition agreement or pursue equivalence with India.

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Project	Objective	Source of funding	Time frame	Estimated Costs
Establishment, modernization, and development of BSTI regional offices at Sylhet and Barisal	Establish BSTI Regional Office cum laboratories in Sylhet and Barisal division to strengthen the Metrology and Certification Marks activities. Enhance the capabilities of BSTI Regional Offices at Sylhet and Barishal with procurement of modern and sophisticated equipment for testing and metrology laboratories; procurement of vehicles for market verification, inspection, and mobile courts.	Government of Bangladesh	July 2005– December 2011	Tk 1873.13 lakh (US\$2.2 million)
Modernization of BSTI through procurement of sophisticated equipment & infrastructure development of laboratories for accreditation	Construct and refurbish laboratories for accreditation Procure sophisticated equipment for different laboratories Upgrade laboratories at Headquarters and Chittagong Regional Office for creating accredited facilities of calibration, testing, and certification Ensure accredited quality of exports from Bangladesh Ensure accredited quality of products to the customer	Japan Debt Cancellation Fund (JDCF); Government of Bangladesh	January 2009– December 2011	Tk. 2295.00 lakh (US\$2.7 million)
Barrier removal to the cost- effective development and implementation of energy standards and labeling (BRESL)	Remove barriers to the development and effective implementation of energy efficiency standards and labeling programs in the region Facilitate the transformation of regional product markets of targeted energy consuming appliances, equipment, and lighting products	GEF; Government of Bangladesh	June 2010–June 2014	Tk. 1863.00 lakh (US\$2.2 million)
Modernization and strengthening of BSTI	Component 1: Develop food testing facilities in BSTI; establish food testing lab with modern and sophisticated equipment Component 2: Establish Gold testing facilities in BSTI; establish Gold testing lab with modern and sophisticated equipment Component 3: Establish cement and brick testing facilities in BSTI; establish cement and brick testing lab with modern and sophisticated equipment Component 4: Build capacity in accreditation in BSTI and establish traceability of BSTI Metrology Laboratory to S.I. units with the help of NPL India. Furthermore, achieve recognition of licences issued on the basis of BSTI product certificates	Exim Bank of India, Government of Bangladesh	October 2010– June 2012	Tk. 7291.51 lakh (US\$8.7 million)

Annex A. Current and Upcoming BSTI Projects

Project	Objective	Source of funding	Time frame	Estimated Costs
Establishment of the office of South Asian Regional Standards Organization (SARSO) in Bangladesh	Promote and undertake harmonization of national standards of the South Asian Association for Regional Cooperation (SAARC) member states with a view to removing technical barriers to trade and enhancing the flow of goods and service in the region Encourage exchange of information and expertise among the NSBs of SAARC member states in the field of standardization and conformity assessment Explore the possibility of having a common mark of conformity among member states Establish the South Asian Regional Standards Organization (SARSO) in Dhaka, Bangladesh to achieve the above objectives	Government of Bangladesh	July 2011–June 2013	Tk. 2211.92 lakh (US\$2.6 million)
Establishment of calibration and verification facilities for the compressed natural gas (CNG) mass flow meter at the CNG filing station at regional level	Establish Infrastructure development of CNG mass calibration/verification laboratories at Dhaka and Chittagong regional offices and a tanker truck calibration center at the Chittagong regional office Procure modern, sophisticated equipment for Dhaka Ensure correct measurement of flow at CNG filling stations and protect meters from tampering	Government of Bangladesh	July 2011–June 2013	Tk. 520.00 lakh (US\$0.6 million)
Better quality infrastructure for the Better Work and Standards (BEST) program	Improve the system of quality management, standards, and conformity assessment of commodities, products, and equipment to international standards Build awareness and capacity of the government and private sector to cope with international quality standards and TBS/SPS enhancement Strengthen legal framework for standards, metrology, and testing in line with the accepted international practice Accredit five labs (mass, temperature, dimension, force and pressure, volume, viscosity and density, electrical, time and frequency) of the National Metrology Laboratory and other existing labs of BSTI Establish national certification bodies for HACCP, ISO 9000, ISO 14000, etc. Strengthen recently established Bangladesh Accreditation Board with technical and financial support from UNIDO Get Bangladesh Accreditation Board full membership from APLAC and ILAC through BEST project and increase promotional activities of lead assessors/auditors	EU/UNIDO; Government of Bangladesh	July 2011– December 2014	Tk. 4826.00 lakh (US\$5.7 million)

Project	Objective	Source of funding	Time frame	Estimated Costs
Expansion and strengthening of BSTI (five districts)	Expand and strengthen BSTI in five districts	Government of Bangladesh	March 2011– June 2014	Tk. 4747.45 lakh
				(US\$5.6 million)
Establishment of Chemical Metrology Laboratory (CML) at	Contribute to the growth of industrialization and reduction of poverty by assisting trade with calibration; help build conformity assessment infrastructure support services at the	Government of Bangladesh	July 2011— June 2014	Tk. 2085.00 lakh
NMI in BSTI	backward linkage for the development, strengthening, and diversification of production and export base of Bangladesh			(US\$2.5 mio)
	Develop, improve, and apply primary methods and reference materials for chemical measurements			
	Provide a pragmatic approach to measurement, traceability, and measurement uncertainty; establish links to S.I. units where appropriate			
	Disseminate expertise and knowledge on chemical metrology through seminars, guides, conferences, comparisons, etc.			
	Establish infrastructure for chemical metrology; build and procure sophisticated laboratory equipment and furniture			
	Procure vehicle			
	Procure Certified Reference Materials (CRMs)			

Sources: BSTI websites, http://www.bsti.gov.bd/bstiOnGoingDevProject.html; http://www.bsti.gov.bd/bstiUpComingDevProject.html.

Trade Facilitation and Logistics

6.1 Efficient logistics are important for enhancing Bangladesh's competitive edge in exports. They reduce costs and delays for exports and expedite imports for consumption and as inputs for domestic production. High logistics costs can be seen as an implicit tax that biases the economy away from exports. Generally, superior logistics performance offers a competitive advantage in an era of increasing globalization, more production sharing across countries, and shortened product lifecycles. To date, low wages have benefitted Bangladesh's ready-made garment (RMG) exports and have partially compensated for poor logistics performance. But to ensure general growth of exports, logistics performance in Bangladesh will need to improve considerably.

6.2 The objective of the chapter is to identify options for tackling four interrelated issues that are critical to Bangladesh's logistics efficiency: (i) the limited use of containers on the Dhaka–Chittagong Corridor and options for reform, (ii) customs and border management modernization, (iii) air transport capacity and connectivity, and (iv) regional transit and connectivity. Our assessment is based on extensive consultations with a broad range of stakeholders. These included government ministries (railways, commerce, communication), transport and logistics regulatory authorities (road transport, inland waterways), port authorities, private sector associations (freight forwarders, cargo agents), exporting firms, the research community, customs, chambers of commerce, shipping lines, export processing zones authorities and investors, and site visits to the Port of Chittagong and the Benapole border post (shared with India).

1 Logistics Performance

6.3 In parallel with the rapid growth in exports of garments in recent years, Bangladesh has already made some progress in improving its logistics performance. There are ongoing reforms in customs and there has been considerable expansion of the road network and performance improvements at the main trade gateway port of Chittagong. However, the 2010 Logistics Performance Index (LPI) published by the World Bank (2010) suggests that although Bangladesh performs above the regional average for South Asia in logistics, it generally ranks below India, which leads the region in performance, as well as other countries at similar income levels. In general, Bangladeshi logistics performance lags in customs, infrastructure, competence of logistics service providers, and tracking and tracing (figure 6.1).

6.4 Growth in Bangladesh's export performance is best illustrated by the rapid increase in cargo traffic through its main international trade gateway of Chittagong. Chittagong handles more than 90 percent of Bangladesh's foreign trade and is the main fulcrum of the Bangladesh logistics system. The port is the fifth largest in South Asia after Jawaharlal Nehru (Mumbai) and Chennai in India, Colombo in Sri Lanka, and Karachi in Pakistan (figure 6.2). In 2010 Chittagong handled just less than 1.4 million 20-foot equivalent units (TEUs) of containerized traffic.





Source: World Bank 2010.

Note: The following countries had to be excluded from the 2012 international LPI sample due to an insufficient number of responses or other data reliability concerns: Bangladesh, Israel, Mali, Mozambique, Nicaragua, Somalia, Turkmenistan, Uganda, and Zambia.





Source: Data from Containerization International (http://www.lloydslist.com/ll/sector/containers/).

6.5 Traffic volumes have been increasing strongly in recent years, especially of containerized cargo (figure 6.3). Containerization of cargo through Chittagong started growing in the late 1980s and in 2010 was just less than half of total cargo volumes. As more and more cargo is containerized, it presents a good opportunity to provide door-to-door containerized service. In fiscal year 2009/10, containers accounted for almost 39 percent of railway freight traffic revenues, three times larger than petroleum products, which were the second highest source of revenue.



Figure 6.3: Volume of Containerized Cargo at Chittagong, 1980–2010

Source: World Bank staff estimates, data from Chittagong Port Authority.

6.6 Containerization over the past six decades has fundamentally transformed logistics. Containers offer several advantages, including the following:

- They are standardized and can therefore be deployed anywhere in the world. Most vehicles, vessels, and railways wagons are designed to accommodate containers.
- They are versatile in that they can be adapted to carry dry cargo, bulk commodities such as coal and grain, cars, and frozen products.
- They can be reused, though ownership largely remains with the shipping lines or specialized leasing firms.
- They can be used to simplify transport management, because charges are often in number of units moved rather than the number of loads or consignments.
- They can be used to secure cargo in transit so that clearances can be done inland rather than at seaports;
- They have lower costs compared to bulk handling of cargo.

6.7 Despite the rapid growth of containerization in Bangladesh, they are not used much in the domestic movement cargo. There is still limited movement of containers inland, with such movement especially by rail lagging the growth in containerized traffic handled at the port. Clearly though Bangladesh joined the containerization revolution in 1981 it has largely not fully exploited the benefits of containerization, although the authorities are keen to improve the systems for inland container movement. Presently, while approximately half of the cargo passing through the port of Chittagong is containerized, less than 15 percent of container depots outside the port but within its vicinity. The containers that move inland are transported mostly by rail (figures 6.4 and 6.5), with only a few transported by road. In 2009 rail moved around 3 percent and 5 percent of loaded import and export containers respectively. Inland waterways within Bangladesh are generally not used to ship containers, although the authorities see great potential in utilizing waterways. In fact the government recently commissioned a new inland port while others are planned both by government and the private sector.

6.8 Growing container volumes moved by rail and inland waterways is key to better integration in the domestic logistics system. This would require arresting a two-decade decline in railway capacity (figure 6.5) and improving inland waterway infrastructure. The latter would help in two respects: (i) avoiding congestion at Chittagong port, and (ii) moving containers using a cheaper mode than road and railways.

Improvements in infrastructure at the Pangaon Inland Container Terminal and introduction of customs facilities will help reduce cargo dwell time, as cargo would be cleared inland; this is already the case with railway-borne cargo. The government has also reportedly authorized the construction of privately owned inland container terminals that will operate the same way. A few such facilities are already being developed near Dhaka and Narayanganj. However, as described below, a major constraint with the inland waterway system is the slow speed of movement.







Source: Estimates using data from Bangladesh Railway. *Note:* ICD = inland container depot.

6.9 A complex picture of several intertwined practices reinforces the established patterns of port clearance of cargo, the stuffing and destuffing of containers in port, and port congestion. To illustrate, destuffing increases demand for trucks on the corridor between Dhaka and Chittagong, which in turn increases congestion on the roads. Furthermore, destuffing takes place in the port, which leads to congestion within the port area and uptake of space; this can then lead to higher infrastructure improvement costs. The main patterns of operation of goods along the Dhaka Chittagong Corridor are described below.

6.10 A large proportion of import containers in particular are stripped within the port itself (around 60 percent).⁷⁰ Customs allows only 17 types of goods that can be cleared in off-dock yards (ODYs) in the Chittagong area (annex A). These are mostly bulk commodities that are not containerized. By customs regulation, containerized cargo may only be removed from the port by rail (to the inland container depot in Dhaka) or to bonded facilities in the export processing zones. As the volumes of containers that are removed by rail are small, current practice is that containers are stripped within the port and then the goods are loaded into covered trucks for removal.

6.11 One consequence of the above practices is that trucks are overloaded, often with the contents of more than one container. Current practice increases both the demand for storage space in the port and the average dwell time for cargo within the port area. Although the port has room to grow, further expansion is taking an infrastructure solution to a problem that probably could be addressed by changing customs clearance procedures.

⁷⁰ Export containers are stuffed outside Chittagong port at various private ICDs/CFSs. Once stuffed and customs approval has been obtained, they are then transferred to the port for loading.

6.12 The stripping of containers adds to handling costs as the goods are then loaded into trucks instead of the more efficient route of transporting containers. As a result, there are a high number of road trucks that move cargo between Dhaka and Chittagong. The Dhaka-Chittagong highway is congested from the high volume of traffic, as well as from bottlenecks at specific locations such as bridges and intermediate centers. Congestion increases transit times and decreases reliability on the corridor. Transit times can be as high as 12 hours when they should be less than 4 hours with free-flowing traffic. Transit times by rail, the only other mode of transport, are even longer (close to 20 hours). The long transit times by both road and rail discourage shipping lines from shipping containers to the inland container depot (ICD) in Dhaka. In generally shipping lines want empty boxes to be returned to the port and repositioned to other ports globally where they will be needed.

6.13 To summarize, the inadequate use of containers is due to a combination of factors. These include inadequate application of risk management procedures in customs clearance and a preference for clearing different types of goods within the port of Chittagong; the limited and unreliable capacity of rail and inland water transport services; and road infrastructure constraints along the corridor. These factors lead to minimal containerization of trade on the Dhaka-Chittagong corridor, which in itself then becomes the most pragmatic and cost-efficient way of transport.

1.1 The Dhaka-Chittagong Corridor <h2>

6.14 A large proportion of the trade traffic handled at Chittagong Port moves on the Chittagong-Dhaka corridor (DCC). The corridor is the most important trade link in the country; estimates are that it directly serves regions accounting for more than half the national population, 57 percent of GDP, and more than two thirds of the country's import and export flows. The DCC has multimodal transport possibilities as it is comprised of road, rail, and inland waterway links. Within the corridor, road transport handles just over half the traffic, followed by inland waters with 43 percent and rail with just over 6 percent. Nationally, road transport is the most important mode of transport, moving more than 80 percent of traffic. Inland waterways handle 16 percent and rail 4 percent. The share of traffic moved by road transport has been growing while that by the other modes has been in decline.

6.15 The poor performance of the DCC has been identified as one of the constraints to further expansion of the garment sector. Berg et al. (2011) identified low railway capacity, poor direct connectivity of the port to international markets, and congestion along the corridor as the major sources of inefficiency. However, railways are presently the most important mode for container movement inland.

6.16 Although Bangladesh Railway has achieved substantial growth in market share in recent years, its potential is much greater than its current share would imply. In 2012, Bangladesh Railways operates unit trains of 76–80 TEU twice a day between Chittagong and the Dhaka ICD in Kamlapur.⁷¹ When properly run, the service has the potential to significantly reduce costs for both importers and exporters in the Dhaka area in particular. The published freight rate for this inbound movement is Tk 6,000 per TEU, while that for backhaul is Tk 3,000 per TEU for loaded boxes and Tk 1,500 for empties. These rates are much lower than those for road freight transport. In addition, when operating efficiently, rail can offer other advantages, including the following:

- Less risk of damage to the cargo by keeping it in the container.
- Faster service, with delivery in about eight hours, although waiting time in the port can be high. The high level of demand for inbound movements has created a 3–5 day wait for wagon space.

⁷¹ Dhaka ICD has a storage capacity for only 1,000 TEU at any one time. It was established in 1987 under the joint ownership of Bangladesh Railways and Chittagong Port Authority. Container handling operations are under the control of Chittagong Port Authority. Since August 1991, dedicated container block trains have operated between Dhaka and Chittagong.

Importers have been willing to incur this delay, even though the cost for a port-to-factory multimodal rail-truck movement is higher, at about Tk 10,000, than for a pure road movement.

• Better customs service and lower informal charges for unstuffing and clearing containers at the Dhaka ICD relative to Chittagong Port (although both are operated by Chittagong Port Authority).

6.17 Inbound movements are loaded containers while most outbound containers are empty. Because there are capacity constraints, loaded boxes are given priority. Capacity is limited by short train length due to track configuration and loop lengths. Also, long headways are needed due to the signaling and loop configuration. For freight train operations, there is the additional constraint of the wagon braking systems that limit maximum speed to 29 kilometers per hour. The large number of train operations has meant high levels of utilization on the major rail links, especially on the route between Dhaka and Chittagong.

6.18 Despite the high level of demand and the potential for future growth, Bangladesh Railway has not increased the frequency of unit train operation. Yet, the unit train operation is Bangladesh Railway's only profitable service and has helped to offset some of the losses from passenger services. The reasons for not increasing the container service include the following:

- Heavy demand on those sections that serve the passenger traffic from the northeast, for example, between Tongi and Bhairab Bazaar and between Laksam and Chakisasma. This is compounded by the limitations of a single track between Tongi and Chinki Astana. The government is now building another track with financing from the Asian Development Bank. This should remove a major operational bottleneck on the railways, although a shortage of wagons and locomotives will still constraint improvements in capacity.
- Government policy favoring passenger services over freight services. Most of Bangladesh Railway's capacity is dedicated to interurban passenger train movements.⁷²
- Lack of commercial incentives for management, which is satisfied with rationing capacity in order to collect a premium (both formal and informal) for the service.
- Rail ICD capacity, which has difficulty handling three trains a day in each direction.

6.19 A number of initiatives that would increase the capacity of the existing network with relatively modest investments and changes in procedures. The measures would include increasing port capacity. The Chittagong Port Authority is planning a new terminal, the Karnaphuli Container Terminal. A feasibility study has already been commissioned. In addition the authorities are looking also at a deep sea port at Sonadia, south of Chittagong.

6.20 A major constraint that is faced at Chittagong is that as a river port it cannot accommodate large vessels, due to limited width and water depth. This is a key reason why Bangladesh cargo is transshipped in Singapore or Colombo. The government has therefore proposed to build a deep water port on Sonadia Island, some 150km south of Chittagong. Feasibility studies for the port were completed in 2009 and the authorities are currently assessing different options for the financing and construction of the port. The port project, which is considered as high priority, has attracted interest from some of the largest port operators, shipping lines and port developers. However, given that construction of the new port as well as efficient hinterland connections will take time to materialize, focus in the short term should be on improving operations of the current port and inland connections.

6.21 One way of increasing capacity is to reduce container dwell time in the port. Cargo dwell time in the port of Chittagong is much higher than the most efficient ports even in middle income countries (Figure 6.6). The dwell time has been reduced from approximately 25 days in 2005 to the current 16 days, which is higher than the larger ports in the South Asia region. However, similar dwell times in

⁷² About 90 percent of train kilometers are passenger services, nearly all of which are customers travelling second class.
efficient ports would be around 3 to 4 days. The long dwell times impose costs on importers and exporters as they have to maintain higher inventories while the port also suffers from poor capacity utilization.



Figure 6.6 Container Dwell Time in Port of Chittagong

Source: Chittagong Port Authority

6.22 Dwell time of cargo in the port can be reduced by procedural reforms as well as improving the efficiency of the hinterland logistics connectivity system. Swederail proposed to increase average train speed through better track maintenance and improvements in rolling stock as one way of increasing system capacity.⁷³ In lieu of operational improvements, Bangladesh Railway would have to reduce the frequency of underutilized passenger services. Since the container trains can be run at any time during the day or night, the effect on passenger services should be minimal. Furthermore, Swederail proposed dual gauges for the line connecting Dhaka and Chittagong as a method to reduce congestion (the link connecting Tongi and Dhaka already has dual gauges), but this idea was rejected in favor of incremental introduction of dual track or construction of a new link connecting Dhaka and Laksam. If Bangladesh Railway changes its policy or increases track capacity, then limited space and road congestion around the rail ICD in Dhaka would create some new problems. As a solution, it has been proposed to establish a new ICD in Tongi, which would also be closer to most of the garment factories. It is clear that in order to increase the proportion of traffic moved by rail, various measures will have to be taken to increase efficiency and capacity.

6.23 The rail service provides a cost-effective means for repositioning of empties through lower backhaul tariff. There are no serious delays for the southbound movement from Dhaka to Chittagong and the ICD provides sufficient storage for empties. However, the benefits to exporters are limited since the ICD does not currently operate as a dry port with a through bill of lading. The shipping lines continue to charge exporters for the round trip movement of the boxes, even if they are loaded in both directions. Further, they require a bank guarantee for movement of empties from the ICD to the factory for stuffing of cargo. Given their interest in controlling how the boxes are used and coordinating their repositioning,

⁷³ Bangladesh Regional Rail Traffic Enhancement Project- TA 3490 Ban, November 2003, SwedeRail, RITES, CPCS Transcom, BETS. See http://www.adb.org/projects/32234-012/main.

the shipping lines have little incentive for offering attractive rates for a backhaul-loaded movement. It is left to the freight forwarders to encourage the loading of the empties stored at the ICD with export cargo. They are able to move the boxes to the factory under a company guarantee rather than a bank guarantee and they can negotiate lower rates with the shipping lines for a loaded southbound movement. The relocation of the ICD to Tongi should encourage this business.

6.24 With expanded services, the railroad would have to reduce its price to attract container traffic currently moving by road and thus ensure a high level of utilization of its service, as well as a commercially oriented management. Rail tariffs are supposed to be based on train operating costs, but container tariffs are comparable to truck operating costs. This is surprising, especially given the age of the rolling stock. As experience with India's Concor service clearly demonstrates, efficient rail transport of containers requires commercial management—if not by the private sector then by a corporatized body operating along commercial lines. ⁷⁴ Concor is part of Indian Railways is operated as a for-profit corporation along commercial lines. Most of its rolling stock was financed through the World Bank. It provides unit train service with rail ICDs stretching across the country and in 2011 it handled about 1.4 million TEU per year. Concor operates a number of unit trains daily to and from various ports, most notably Nhava Sheva and Kolkata. It has demonstrated a willingness to open new markets, such as Nepal's rail ICD and various joint ventures with private transport companies. It has also expanded service where there was sufficient growth in demand. At the same time, it has stopped service where traffic has not materialized.

6.25 The plan to establish a rail ICD at Tongi should be implemented as soon as possible. The existing Dhaka rail ICD in Kamlapur operates more efficiently than the container yard in Chittagong Port, but its location in the congested city center restricts access. A better location for this facility would be a site nearer to the garment factories with good road access. Since a significant number of the garment factories are located northwest of Dhaka, Tongi seems to be a good choice. A similar facility in the Narayaganj area would not be needed since the knitwear manufacturers use less imported fabric and yarn and are more likely to use road transport, which is both faster and cheaper. While the Dhaka rail ICD serves traders supplying imports to the consumers in Dhaka, it is unclear whether this facility should remain open, given the increasing congestion and the potential value of the site if used for commercial purposes.

1.2 Logistics Services

6.26 The government has invested heavily in improving roads in recent years, but the numerous problems remain. The road network now comprises over 270,000 kilometers, most of which was constructed over the past 40 years. A new bridge across the Jamuna River improved east-west connectivity in the country; another that is planned across the Padma River will do the same for the southwest part of the country. The bridges, which carry railway lines as well, are important not just for Bangladesh but also for connectivity with India.

6.27 There are two trucking markets in Bangladesh, one modern and the other largely informal and underdeveloped. The relatively modern market is based on the RMG industry, which has played a major role in the development of the sector, especially on the DCC. The RMG industry accounts for as much as two thirds of the volume carried on the DCC (Raihan, Eusuf, and Ifthekar 2010). The sector has encouraged the emergence of modern trucking services based on contracts for services at an agreed price. While these services tend to be expensive, they offer a predetermined quality of service, for which they charge a premium. The non-RMG trucking services suffer from poor quality and low reliability. The services are highly competitive, perhaps because they are also highly fragmented. There are numerous

⁷⁴ There are some examples of public railroads successfully operating high-volume container train services, such as the Republic of Korea's Pusan-Seoul service, but these are generally correlated with strong government policies promoting the service.

operators using old fleets. In addition, there is also a high level of vehicle overloading. In an effort to mitigate competition, the operators typically have to go through transport brokers to obtain loads, especially on the Benapole-Dhaka route. The market is therefore distorted, because the brokerage industry or clearing and forwarding agents control access to and competition for services. Going through agents is often the only way to obtain loads. One of the major constraints faced in this secondary market is the lack access to financing that could be used to modernize fleets and improve access to new business. To expand, operators either use their own savings or borrow from relatives. Reform of trucking services in Bangladesh should therefore target the non-RMG market, which accounts for approximately half of the trucking services in the country (Raihan et al. 2010).

6.28 Bangladesh has a well-established logistics industry, although it presently concentrates mostly on clearing and forwarding services. There are more than 500 registered clearing and forwarding agents in the country, including major global players. Since 2008, the industry has been regulated through a Statutory Rules and Order (SRO) issued by government. The SRO clarifies the ownership of freight forwarding firms and the requirements for licensing. Reportedly the SRO has contributed to improved quality of forwarding services. However, most forwarders only handle the domestic components of both import and export logistics, except to a few markets such as Africa. Most exports are free on board (FOB) to Chittagong. The main constraints to the operation and efficiency of logistics services providers are as follows:

- Restrictions on establishing bonded warehouses. Although the government allows the private sector to operate ICDs and container freight stations, there are still restrictions on clearing and forwarding firms, particularly for establishing bonded facilities. The ability of such firms to have bonded facilities is a characteristic of modern logistics in other countries. It is particularly helpful to small and medium enterprises that ship less than container loads and can then benefit from consolidation possibilities in bonded facilities. Forwarders and major trading firms in Bangladesh are interested in investing in such facilities, as this would allow them to pack cargo into containers and receive imports on their premises. Customs could take immediate steps to allow the opening of bonded warehouse facilities around the country, but especially along the core DCC. This may increase costs for customs but will likely lead to significant cost reductions for exporting firms. The facility to establish bonded facilities could be extended to reputable firms, consistent with the proposed move to have authorized economic operators.
- Restrictive foreign exchange controls, especially for FDI. Clearing and forwarding firms face onerous requirements to access foreign exchange approvals to invest in other countries as part of their networks to offer door-to-door services, especially to the main trade markets. These make it impossible for Bangladeshi operators to establish a presence in key overseas markets. As a result they are limited to playing mostly a domestic role.

1.3 Inland Waterways

6.29 Water transport in Bangladesh has a large but unutilized potential. More than 10 percent of the population of Bangladesh has direct access to the inland waterways transport system (IWT). There are three main types of services offered:

- Trunk haulage of passengers and freight along major waterways, between economic centers and port gateways, and between India and Bangladesh. Volumes are highest on these services, which have also tended to have some of the most modern vessels in the system. Types of cargo have been dominated by bulk and petroleum products, fertilizers, construction materials, and grains.
- Feeder services. These are usually short trips with modest traffic volumes for small enterprises and farmers.
- Ferry services. These provide continuity of road transport services. They are essentially part of the road networks rather than the IWT.

6.30 Although inland waterways are cheaper than other modes of transport, they suffer from poor performance. Generally, the volumes of cargo moved by the IWT have stagnated over the past decade. This mode is slow (16-20 hours between Chittagong and the ICD to the south of Dhaka). Although this is somewhat faster than the current rail service for inbound containers, it is slower than road transport, especially when door-to-door movement is considered.

6.31 The IWT has been promoted as an alternative mode for transporting containers between Dhaka and Chittagong, but not many containers are moved by water. Earlier efforts were motivated by the limited capacity of road infrastructure. More recent efforts have focused on reducing congestion and delays. Still, interest in exploiting the IWT remains high. For instance, the government recently built the Pangaon Inland Container Terminal, though full operations are being limited in part by a shortage of vessels. There is also a proposal to establish barge facilities for containers moving between Chittagong and Narayanganj, involving private barge terminals operations at either end. The barge service would be privately operated under a separate contract. The operating costs for barging would be less than for other modes, but the door-to-door costs are likely to be comparable when the terminal handling and road transport from Narayanganj to the destination are included. In the end, the market share for the proposed barge service will depend on the behavior of the other two modes, specifically the level of congestion on the roads and the pricing and frequency of the unit train service. An IWT service could capture a significant share of the movement of empties, but it would have difficulty capturing a significant share of the movement of loaded containers.

6.32 Development of the IWT sector would also require strengthening the regulatory oversight of transport services. There are two bodies with regulatory responsibilities for IWT in Bangladesh. These are the Department of Shipping, which is responsible for safety and overall regulation of the sector, and the Bangladesh Inland Water Transport Authority (BIWTA). BIWTA is responsible for dredging services, navigational aids, management of inland ports, and regulation of transport operations, among other functions. Often the separation and allocation of responsibilities between the two is not clear. For the development of water transport, it is important that the functions of the two regulators are streamlined and the allocation of roles clarified.

6.33 Priorities for improving use of the IWT should include the following (see also chapter on shipbuilding):

- **Improving service performance.** The IWT has great potential to move higher volumes of cargo, especially between Dhaka and Chittagong and between India and Bangladesh. It can help relieve some of the pressure from low railway capacity and congested roads. However, making this happen would require dredging channels, improving IWT port capacity near Dhaka, and acquisition of more efficient vessels. Some of the improvements can be made by the private sector.
- Streamlining regulation of the IWT. Presently, there is overlap of regulatory functions between the Department of Shipping and BIWTA. Developing the sector to its full potential requires a streamlining of sector management. With proper regulation, inland water transport can help Bangladesh reduce the environmental impacts of transport operations as it is more efficient and generates lower carbon emissions than other modes.

1.4 Air Shipments

6.34 Air freight in Bangladesh has been growing steadily over the past few years. The principal gateway for airfreight is Dhaka's Shahjalal International Airport in Dhaka. There are several scheduled air freight services by most of the airlines from East Asia, the Middle East and other regions (including BA, Cathay Pacific Emirates, China, Qatar, Saudi, and Singapore airlines). Services are typically twice per week. Through hubs in the Middle East and the East Asia region, Bangladesh is connected to the rest of the world. Air charters are also used, especially during the periods of high demand, July to October.

Airfreight is used mostly by the garment industry, usually at the buyer's request, and sometimes in the case of a missed ocean shipping date. For normal shipments, one of the practices is to use a sea-air combination: ship by sea to Dubai and air freight from Dubai to Europe and the United States. The forwarding community and exporters do not experience many problems with air transport except during the peak period.



Figure 6.6: Airfreight from Dhaka Airport, 1998–2010 ('000 tonnes)

Source: Bangladesh Bureau of Statistics, various years.

6.35 Most of the problems with air freight are experienced on the ground, in particular with respect to the management of the air cargo terminal in Bangladesh:

- Performance of the terminal and ground handling monopoly. Ground handling and management of the air cargo terminal at the airport in Dhaka is performed by a subsidiary of the national carrier, Biman Airlines. Cargo is brought in by the cargo agents, typically 30 hours before departure. Clearing and forwarding agents report two problems with the current arrangements, the first of which the mission was able to confirm. First, the terminal area is often congested, partly due to increasing cargo volumes but also due to poor performance in the handling and clearance processes. Second, although agents pay Biman for all services, they often have to hire their own labor for the same purpose. Current management and practices therefore increase costs for airfreight logistics. Biman maintains that their role is not driven solely by commercial interests, but their operation should nevertheless be scrutinized for practices that could be detrimental to efficiency in logistics services. Infrastructure improvements are also necessary at the terminal to increase capacity and space, including the acquisition of scanners able to handle airfreight pallets and other unit loads.
- The clearance process for small consignments. A contributory factor to congestion at the cargo terminal is the clearance process, even for small shipments. While Bangladesh has a simplified procedure for small shipments and Section 18 of the Customs Act provides for the non-levy of duty and taxes on such shipment, the limit in value of Tk 1,000 per consignment is very low. As a result most shipments of samples for the garment industry exceed this value and are caught. As a result, the packages are treated the same as all other shipments, resulting in clearance times that take 1–5 days even for garment samples. The adoption and introduction of procedures for expedited clearance of small shipments, consistent with WTO guidelines could be one possible solution to this problem.

2 Customs and Border Management

2.1 Risk Management

6.36 The National Board of Revenue (NBR), which manages customs, has implemented various reforms that have led to some improvement in customs performance in Bangladesh. It is possible for customs brokers to submit data electronically to the customs system⁷⁵ and for ship agents to electronically file vessel manifests (though the two systems are not integrated). In 2008, Chittagong Customs House, in cooperation with Chittagong Chamber of Commerce and the private sector, were involved in an automation project to interface their systems and to enable online access to the customs system. Under that initiative, the Bill of Entry Module for online submission of customs declarations (Direct Traders Input) by importers/C&F agents were implemented at both Chittagong Customs House and Dhaka Customs House. More recently, it is now possible for importers or their agents to submit declarations online from their own premises, unlike in the past when they could only do so in a customs station.

6.37 NBR is taking steps to further automate customs processes. It is currently working on introducing ASYCUDA World⁷⁶ in 2013 starting at the Port of Chittagong. The plan is to interconnect all the customs stations so that declarations can be lodged from anywhere. In addition, NBR is also working to introduce a "single window system" starting at Chittagong Customs House. Already, ship agents can file vessel manifests electronically, though hard copies still have to be submitted.

6.38 However, despite the above improvements, informal payments are still common to facilitate clearance of goods. A major accomplishment in July 2013 was the phasing out of pre-shipment inspection. Until then, Bangladesh customs relied on the services of PSI services provided by four firms: Bureau Veritas, Intertek Testing, Société Générale de Surveillance S.A. (SGS), and Overseas Merchandise Inspection Company (OMIC). While it was claimed that PSI improved revenue collection, reporting on the declarations,⁷⁷ and cargo clearance time by 1–2 days on average, the program has not been without controversy (Arnold 2010). Globally, PSI firms provide customs with important risk-related functions and can enhance integrity in the clearance process. The PSI program requires a pre-arrival processing of documents. It is used to verify the description, quantity, classification, and valuation of the goods being exported to Bangladesh and to issue a Clear Report of Findings. In Bangladesh the PSI system were working as efficiently as can be expected. On paper, 10 percent of PSI and 100 percent of non-PSI shipments were supposed to be subject to physical examination. However, the actual physical examination rate for PSI shipments was much higher (close to 50 percent). There are around 8,000 disputes pending in the courts relating to the certifications by the PSI agencies—a small proportion of the total declarations. The disputes were usually about classification and valuation of imports and what was regarded as poor performance by the PSI companies (Mahmud and Rossette 2007; Uzzaman and Abu Yusuf 2011).

6.39 With the phase-out of PSI, the services previously offered by the private firms have become part of the normal functions of customs administration. In any case, risk management is a core component of a modern customs administration. Customs should therefore provide the resources and training of their staff to better target their interventions on areas that pose the most risk. The International Finance Corporation, the private sector arm of the World Bank Group, reviewed the government strategy and identified some priority actions that could be undertaken as part of capacity building upon phasing out PSI in Bangladesh (see box 6.1).

⁷⁵ Bangladeshi customs uses a version of the UN's Automated System for Customs Data (ASYCUDA++). See http://www.asycuda.org/.

⁷⁶ See http://www.asycuda.org/.

⁷⁷ Review of pre-shipment inspection in Bangladesh, Manzur Ahmed http://www.thefinancialexpressbd.com/more.php?news_id=17515.

Box 6.1: Priority Actions to Phase Out PSI

- **Risk management.** Establish a risk management unit with officers able to analyze, prioritize, and design responses to risks associated with particular kinds of cargo shipments. Program should include a risk management policy, a standard risk profile, extensive coordination and communication with all entities (companies and other government agencies) involved in the trade process, a postclearance audit program and unit, trained analysts, and a formalized compliance program.
- **Customs valuation.** Follow WTO Valuation Agreement standards, where the preferred basis of appraisement is "transaction value," defined as the "price actually paid or payable" by the buyer for the imported goods.^a This expanded role for Customs may require a significant change in current work processes for Customs Officers and will require specialized training.
- The World Customs Organization (WCO) Harmonized System. Develop classification capacity for customs based on the Harmonized System, the WCO's system of code numbers for identifying products, since the classification and explanatory notes can be quite complex. Refresher training for customs officers may be required.
- **Trade compliance and enforcement.** Provide support to staff and management to balance the actions taken when reviewing import/export documentation and/or physically inspecting commercial goods.
- **Custom automation.** Enhance current processes and procedures through automation, in preparation for transition from the existing PSI regime.

Source: World Bank 2012. Note: a. http://www.wto.org/english/tratop_e/cusval_e/cusval_info_e.htm.

6.40 The government has since taken measures consistent with the above priority actions in preparation of phasing-out PSI. Chief among the actions taken was a significant increase in and training of customs staff, to accompany the July 2013 phase out of PSI.

6.41 A complementary action that authorities could also take is to implement an Authorized Economic Operators (AEO)⁷⁸ program. An AEO is a party involved in the international movement of goods in whatever function that has been approved by or on behalf of a national customs administration as complying with World Customs Organization (WCO) or equivalent supply chain security standards. The operator satisfies certain criteria and is considered to be reliable in customs-related operations. The operator is therefore entitled to certain benefits and greater trade facilitation, such as simplified and rapid release procedures on the provision of minimum information. The criteria include having an appropriate record of compliance with customs requirements, a demonstrated commitment to supply chain security, and a satisfactory system for managing commercial records. Typically, an AEO program is developed and implemented in phases, reflecting the capacity of both the authorities and private sector readiness to participate in such a program. The Revised Kyoto Convention already provides some of the steps that customs could implement to facilitate authorized operators, forming the basis for an AEO program.

6.42 An AEO program for Bangladesh would help address several objectives, including faster clearance of some goods and, as a corollary, freeing customs and other border management resources to target those consignments that pose the most risk.

6.43 To summarize, specific actions to improve risk management in Bangladesh include the following:

⁷⁸ The World Customs Organization (WCO) SAFE Framework of Standards defines the SAFE Authorized Economic Operator (AEO) as an entity complying with WCO or equivalent supply chain security standards and with legal obligations in relation to tariff and nontariff requirements on the import, export, and transit of goods.

- Focus on specific tariff lines or products that pose the highest risks. A national risk profile, based in part on the experience of customs and PSI firms, could be created to identify activities that have the most impact on revenue protection and collection and regulatory compliance. The profiles can be tuned to the flows handled at different customs houses; for example, traffic at Chittagong is different from that handled at Benapole.
- The management of risk should be automated as much as possible, based on international best practices. The ASYCUDA World system that is being developed has a capability to enhance risk management in a flexible manner. In order to improve the system, customs should record examination results in a systematic and consistent manner. For a start, customs should obtain data from the PSI firms so that it can develop a risk management database.
- Define a clear risk management policy that identifies roles and responsibilities for different levels of customs staff. In addition it is important to also strengthen the post-clearance audit system. Presently the post clearance audit function is performed by the same commissionerate that also deals with customs valuation. It would be important to have a dedicated post-clearance audit unit that is fully staffed, especially at the offer level and equipped to offer services at all major ports. This should be considered as part of a comprehensive risk management regime.
- Introduce an AEO regime for selected supply chain participants. This could start with the established garment manufacturers. Such a program would free customs resources to target those consignments that pose the most risk, especially following the phasing out of PSI.

2.2 Land Customs Station Management

6.44 Presently, most of the land customs stations are not automated and use manual systems. Bangladesh has an extensive network of land customs stations. The most dominant one is Benapole, which is on the main land trade route with India. A project is underway whereby NBR is working with the United Nations Conference on Trade and Development (UNCTAD) and customs to introduce ASYCUDA World software, which would enable the connecting of the five major customs houses and the ten largest land customs ports. This is expected to be in place late 2013. Customs intends to build on this system to introduce a single window system to integrate all border agencies at the various customs houses around the country.

6.45 Clearance times are typically 2–3 days at the smaller stations and within 5–6 days at Benapole (figure 6.7). At Benapole, 80 percent of declarations are assessed within a day of being lodged, whereas it takes up to 5 days to clear 80 percent of goods for release after declaration. The clearance times at the land customs stations are affected by several practices that increase time and cost. The main one is the current practice of transloading cargo between trucks registered in Bangladesh and those registered in India. This practice has several consequences, including the need to provide warehousing space and equipment to handle and store goods, and labor to handle the goods. A solution to these inefficient practices lies in the two countries agreeing on modalities for the penetration of trucking services into each other's territory.

6.46 The problems and possible solutions to problems often found at Bangladesh's land border crossing points are summarized in table 6.1 below. The problems are most commonly found at the major land customs statiosn such as Petrapole-Benapole and Akhaura-Argatala, the largest ports between mainland India and Bangladesh and Bangladesh and NE India respectively.

6.47 Generally, as shown above there are common issues that could be addressed to improve overall efficiency at the land border posts. Some of the measures can be short-term measures including the following:

Figure 6.7: Cumulative Distribution of Customs Clearance Times at Benapole Land Customs Station (November 2011 to February 2012)



Source: World Bank staff estimates, data from Bangladesh Customs.

Problem	Possible Solutions
Access roads to land border crossing points are often narrow with not enough space for vehicles to be parked on the road side. This creates congestion and delays which result in high truck demurrage charges to Bangladesh exporters.	India has built or is planning integrated check posts at several borders with Bangladesh. However, while the facilities should help address the space constraints that are faced, the access roads between the two sides are not always properly aligned. There should be active engagement between the two sides on development plans.
There is often not enough space or sheds for transloading.	Space for transloading should be larger on the side that is importing more volume than the other. There is need to match capacity to need.
Differences in border opening hours on the Bangladesh and India sides as the early closure at 5pm reduces the average work day to 6-7 hours. In addition, there are differences in holidays each week, further reducing the commercial work week by two days.	There is need to synchronize border opening hours between the two sides. A system of pre-arrival processing of documents could be introduced to expedite clearance.
There are labour syndicates on both sides of the borders, who increase transloading costs.	Measures should be taken to abolish syndicate practices at the border posts. Transloading could also be mechanized to improve efficiency.
Customs only clear goods if the complete consignment has arrived.	Processing could be allowed for split consignments.

- **Increase and harmonize border working hours.** Presently the land ports do not operate fully on Friday in Bangladesh and on Sunday in India. Two days of clearance are therefore lost each week.
- Allow pre-arrival clearance of goods. Some countries have realized significant gains from allowing the processing of documents to start before goods get to the border. The goods can therefore be cleared as soon as they arrive and customs and other agencies are able to carry out any physical verification they may desire.

• **Increase capacity for handling transloaded goods.** In the interim before phasing out transloading of goods, capacity for handling such cargo should be increased. Current practices are designed around significant use of manual labor and the involvement of hundreds of people at each border post in the transloading business. Some of the processes can be automated to expedite movement of goods.

3 Regional Integration and Trade Facilitation

6.48 A review of trade facilitation and logistics performance in South Asia illustrates continued weakness in several areas. This is reflected in the very low intraregional trade volume compared to trade with other regions, although South Asia has great potential as one of the main sources of global growth. Recent political developments have opened the possibility that the objectives of the South Asian Free Trade Agreement (SAFTA) of 2006 can move further ahead. As the countries look toward deeper integration, it becomes increasingly obvious that there is need to address some of the constraints that increase transport and logistics costs.

6.49 Infrastructure interconnectivity is a fundamental building block for a regionally integrated transport system. While South Asia has a basic interconnected road network, road transport operations are hampered by differences in market access policies, axle load limits, quality requirements, and so forth. Cargo that is compliant in one country may exceed limits in the next country. Similarly, railways in the region have a combination of meter and broad gauge lines. This impedes cross-border movements, where these are allowed. Bangladesh has had to construct both gauges in some parts of the network to interface with the Indian system. Infrastructure differences take time and cost large amounts of money to accommodate. However, some of the major constraints lie in the policy choices of the countries.

6.50 For example, there are differences in axle load limits between Bangladesh and India, with which it shares the longest border (table 6.2). Axle load limits in Bangladesh are consistently lower than those in India, for the same class of trucks. This could be a reflection of weaker pavements in Bangladesh; or it could reflect a regulatory legacy where the limits have not kept pace with recent trends in trucking technology. In fact, the differences in axle load limits are cited as one reason for denying India transit rights across Bangladeshi territory. Of course this is only one reason, and possible not the main reason, for denying such transit rights. Various other political, social, and economic considerations are also pertinent. As discussed below, there are whole industries and a large number of people already engaged in transloading of cargo at the borders. These stakeholders would be affected by a change in policy, regardless of the economic inefficiencies involved in the status quo.

Vehicle type	Bangladesh	India
3 axle (1 front, 2 back)	22	25
4 axle (steering + 3 axles)	25	31
5 axle (3 prime mover, 3 trailer)	38	44
6 axle (3 prime mover, 3 trailer)	41	44^{a}
7 axle (3 prime mover, 4 axle)	44	

Table 6.2: Gross Vehicle Weight Limits in Bangladesh and India (in tonnes)

Source: World Bank staff estimates, data from various sources.

Note: a. Nominal weights are 45.4 and 54.2 tonnes, but 6-axle vehicles are restricted to 44 tonnes.

-- = Not available.

6.51 For efficient cross-border movement of cargo, it is essential that road, rail, and inland waterway vehicles are allowed to cross borders and deliver goods from origin to destination seamlessly. Due to the shape of borders in the region, Bangladesh could serve as a transit country for trade between mainland

India and Indian northeastern states, and also for Nepal and Bhutan. As discussed earlier, movement of vehicles is not possible across Bangladesh's borders, whether for transit or for goods bound for Bangladesh. Goods therefore have to be offloaded at the border and transferred to vehicles from the other country. This practice is inefficient. The same applies also to railways where locomotives have to be changed. Recently, however, the governments of India and Bangladesh have been discussing how Indian traffic can cross from the mainland to the northeast states across Bangladesh. The intention is primarily to allow traffic between western Bengal and the landlocked Indian states in the northeast. Such transit would halve travel distance to about 500 kilometers.

6.52 Dealing with transit rights between two coastal countries is possible but much more complex than between coastal and landlocked countries, where there are clear international rules and traditions. The complexity is apparent in the ongoing discussions and negotiations between India and Bangladesh. Each side has undertaken studies on what the impacts could be. It would appear the Bangladesh preference is for a regional approach so that transit is dealt with from a broader perspective that includes also landlocked Bhutan and Nepal. The countries have some mechanisms in place to exchange traffic including Standard Operating Procedure (SOP) for movement of vehicles from and to India, Nepal and Bhutan up to customs controlled areas on each side of a border. However, the existing arrangements still require the transloading of cargo from the vehicles of one country into those of the other, a practice which is inefficient.

6.53 Meanwhile while the discussions for a broader framework are ongoing, India is of course already developing alternative routes to reduce costs between the northeast states and the mainland. It is financing the development of a port (Sittwe), road, and mode interchange facility in Myanmar that will be part of a multimodal system between Kolkata and Sittwe to the state of Mizoram and the rest of the northeast region.

6.54 A comprehensive transit framework has the potential to transform the trade facilitation environment in South Asia particularly if it is extended also to accommodate traffic to and from Nepal and Bhutan. The latter may then be able to access Bangladeshi ports much more efficiently, especially Mongla. The problem here is a very specific one that requires a practical transit solution on a few identified road corridors with significant traffic potential. Two of the main considerations are as follows:

- A functional transit procedure through Bangladesh that would allow seamless movement of goods between western Bengal and the northeast states of India, with no significant waiting time at the border or en route due to inspections or transloading.
- Adequate cost recovery mechanisms for Bangladesh, to recoup the costs associated with required infrastructure and services, according to universal principles on freedom of transit.

6.55 A formal agreement between the countries would be required for any new initiative to work. The alternative to the transit procedure described above would be through the Siliguri Corridor or "chicken neck" in India,⁷⁹ which would essentially set an upper bound for the performance of the transit route across Bangladesh. For example, in the case of a tractor-trailer rig that travels at least 500 kilometers a day, delays probably should not exceed three hours at each border. This is a very demanding target, given current levels of performance where delays of several days are not uncommon. A formal agreement may also open the way for a multilateral approach that includes and benefit the landlocked countries of Bhutan and Nepal.

6.56 Ratification of international instruments can help with regional harmonization of trade facilitation practices. A possible solution to all the above problems could be the ratification of a set of seven international conventions by all South Asian countries. This could become the foundation for integrated

⁷⁹ http://en.wikipedia.org/wiki/Siliguri_Corridor.

trade and transport systems as recommended by the UN Economic and Social Commission for Asia Pacific (UNESCAP) in 1992 (see table 6.3).⁸⁰

	Title	Date
1.	Convention on Road Traffic	Vienna, 8 November 1968
2.	Convention on Road Signs and Signals	Vienna, 8 November 1968
3.	Customs Convention on the International Transport of Goods under Cover of TIR Carnets (TIR)	Geneva, 14 November 1975
4.	Customs Convention on the Temporary Importation of Commercial Road Vehicles	Geneva, 18 May 1956
5.	Customs Convention on Containers	Geneva, 2 December 1972
6.	International Convention on the Harmonization of Frontier Controls of Goods	Geneva, 21 October 1982
7.	Convention on the Contract for the International Carriage of Goods by Road (CMR)	Geneva, 19 May 1956

Table 6.3: The Seven UNESCAP Conventions

6.57 The seven international instruments cover infrastructure, service and transit needs for a regionally integrated system. Among the instruments is the Customs Convention on the International Transport of Goods under Cover of TIR Carnets (TIR). The TIR is a system of bonds, operated in nearly 70 countries, that guarantees that any customs and other duties will be paid on goods transported in transit trucks. Its objective is both the improvement of transport conditions and the simplification and harmonization of administrative formalities in international transport, particularly at frontiers. The TIR has three important principles:

- Goods carried under the TIR procedures in sealed road vehicles are not as a general rule submitted to examination in customs offices en route. But they may be inspected when an irregularity is suspected. Customs authorities do not require vehicles to be escorted at carrier's expense on the territory of their country.
- The contracting parties authorize agreed professional associations to issue TIR carnets. These associations guarantee that they will pay the import or export duties (of course, if the goods are moving from India to India via Bangladesh, there should be no duties) and taxes, including penalty interest in case of irregularities. For the purpose of identification of the goods on which duties have to be paid, details of these goods are entered in the TIR carnet. Customs authorities discharge TIR carnets after conclusion of the transport operation. Discharge is equivalent to clearance and customs authorities cannot claim taxes and dues after discharge.
- Irregularities render the offender liable to the penalties of the country where the offence was committed. In case of doubt, the offence is deemed to have been committed in the country where it was detected. Any person guilty of irregularities may be in future excluded from the operation of the TIR.

6.58 In South Asia, only Afghanistan has ratified the TIR convention. One of the likely benefits of India and Bangladesh in particular acceding to the TIR are the potential spillover effects beyond South Asia. Nepal and Bhutan are landlocked and need access to seaports and harmonized agreements to reduce

⁸⁰ See UNESCAP (2007).

time and costs.⁸¹ They could therefore more easily access the ports of Bangladesh, which are the closest. A functional regional transit system is therefore an imperative for South Asia. The TIR would also greatly benefit transit trade with Afghanistan as it can be an instrument to address concerns over likely diversion of goods in transit into the Pakistani domestic market. However, Pakistan and India have only made tentative moves to accede to the TIR Convention. In the case of Pakistan, progress stalled over attempts to have reservations on some provisions of the TIR convention, which is not allowed. Acceding to the convention seems contentious in Pakistan, and an official decision has been made to suspend the efforts until there is consensus.

Bangladesh does not presently have an effective institutional mechanism to promote trade 6.59 facilitation and logistics upgrading. The existing mechanism, through the National Trade Facilitation Committee does not have the powers necessary for a proactive and robust definition of a trade logistics strategy. It certainly does meet the trade facilitation obligations under the WTO framework, but some of the constraints now faced are much more about the interface between the physical infrastructure and meeting regulatory requirements for the movement of goods. Like other countries, Bangladesh has numerous agencies that play a role in trade facilitation and logistics. These include customs, chambers of commerce, the land port authority, port operators, railways, roads, inland waterways, clearing and forwarding agents, security services, and so forth. However, the country does not presently have an effective institutional mechanism for these players to coordinate their actions to improve overall performance. The lack of proper coordination is evident in the manner in which transit issues have been pursued, where a holistic assessment of the costs and benefits of transit has not gained enough traction. In other countries such as Pakistan, coordination of trade facilitation reforms is pursued through a national trade facilitation committee. Bangladesh should both broaden the coverage and strengthen the capacity of the national trade facilitation committee to play a more proactive role in guiding trade facilitation and logistics reforms in the country.

4 **Options for Improving Trade Facilitation and Logistics Performance in Bangladesh**

6.60 The main findings of the analysis presented in this chapter that could frame the action matrix are as follows:

- The current practice of stripping containers in the port or in the Chittagong area increase cargo clearance time, costs, and port development costs. They deny Bangladesh exporters the benefits of containerization, which is fundamental to modern logistics.
- The railways are fundamental to increased utilization of containers on the domestic corridor. Presently the railways suffer from low capacity and poor reliability, which contributes to limited movement of containerized cargo. Proposed plans to dual-track the main line between Dhaka and Chittagong should address capacity constraints, but would require also improved procedures at the port to expedite movement.
- Development of an inland waterway transport and logistics system will increase its viability as an option for moving containers inland. However, the overriding issue is the comparatively slow speed of water transport. This makes it less attractive to shippers, especially in the garment industry. A more comprehensive approach is needed that will also include modernization of the vessel fleet.
- There is presently poor coordination among agencies at the border, which increases costs and clearance time and reduces reliability.
- There are high costs and disputes associated with using PSI. Some PSI shipments are subject to price and quality disputes. The intention of government to phase out PSI is validated by the

⁸¹ While countries may negotiate regional agreements on transit, the TIR remains the only proven functional system for international transit.

evidence, but customs needs to build adequate internal capacity to take over proper valuation of goods.

- Air shipments can be expedited through the adoption of the WCO's Immediate Release Guidelines. Presently, even samples are subjected to the same clearance formalities as all other cargo.
- The trucking industry needs a reform strategy for modernization and improved performance. Most trucks deployed on the DCC are not designed to carry containers. Long transit times and congestion limit movement of containers by road. This is partly due to infrastructure constraints, especially two narrow bridges that act as choke points.
- Whole industries and communities have grown up around the land customs stations, largely to facilitate transloading—moving goods from vehicles of one country into another. Thus, significant political economy issues will have to be addressed if the South Asia region is to facilitate seamless trucking across international borders. Countries would first have to negotiate either regional or bilateral instruments allowing the cross-border movement of trucks.
- Air transport is inefficient due to congestion and lack of capacity at the air terminal. The terminal is run as a monopoly. Options to increase competition should be explored.
- Exchange control rules force clearing and forwarding agents to play only a local role. [[The main constraints to the operation and efficiency of logistics services providers are (i) restrictions on establishing bonded warehouses and (ii) restrictive foreign exchange controls, especially for FDI.]] As product value chains become more sophisticated, Bangladesh operators will want to manage outbound chains as well. However, this issue goes beyond just logistics services providers and is relevant to several other aspects of the diagnostic trade integration study.

6.61 Good logistics are important for enhancing Bangladesh's competitive edge in exports. To date, low wages have benefitted Bangladesh's RMG exports and have partially compensated for poor logistics performance. But to ensure continued rapid growth of exports, logistics performance in Bangladesh will need to improve considerably. In this chapter, we have identified options for tackling interrelated issues that are critical to enhancing Bangladesh's logistics efficiency.

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Annex A. List of Goods that Can Be Cleared in Off-Dock Yards

Headings are from the Harmonized System, the WCO's system of code numbers for identifying products.

- 1. Rice (Heading 1006)
- 2. Scrap (includes meltable and rollable scrap under Heading 72.04)
- 3. Wheat (Heading 1001)
- 4. Mustard (Heading 21033000)
- 5. Waste Paper (under Heading 48.07)
- 6. Chick Peas (under Heading 07.13)
- 7. Pulses (under heading 07.13)
- 8. Raw Cotton 9Heading 52)
- 9. Hard Coke (Heading 27040000)
- 10. Carbon Black (Heading 27030000)
- 11. Marble Chips (Heading 251741000)
- 12. Ball Clay (Bulk good, Heading 25083000)
- 13. Onions (Heading 07021019)
- 14. Ginger (Heading 09101090)
- 15. Garlic (Heading (07032090)
- 16. Fertilizer (Heading 31010000-310590000)
- 17. Animal feed (Heading 23.09)

Constraints to Trade Finance

7.1 Lack of access to finance and to competitive trade financing instruments has often been identified as a hindrance to trade. The shortage of medium-term finance for the purchase of capital equipment is of crucial importance to new exporters and companies wishing to diversify their exports. Despite significant efforts by the government and nongovernmental organizations, only 33 percent of all small and medium enterprises (SMEs) in Bangladesh have received at least one loan from formal financing institutions. This means a large majority of existing SMEs do not have access to bank finance, and this acts as a constraint to export growth and the entry of potential new exporters into the market.

7.2 Moreover, at a time of general liquidity shortages, access to finance can get further squeezed, as happened in FY 2011/12, when a surge in government borrowing crowded out affordable access by the private sector. This squeeze severely inhibited the banking sector's ability to finance the growing export industry. Very tight monetary conditions resulted in reduced availability of trade finance and working capital loans. The banks were also requested by Bangladesh Bank to decline requests to open import letters of credit (L/Cs) for "luxury" products. (FY13 update)

7.3 The provision of trade finance support is important for lowering risks for exporters and helps mitigate the local currency shortage. Trade finance is particularly important during the initial stages of exporting (for example, for new firms, and at the extensive margin where new products and new markets are being established) as well as during periods of macroeconomic uncertainty. Lower risk reduces barriers to entering and sustaining exports (increasing export survival) as well as lowering trade cost (through financing costs). Moreover, while foreign currency financing at usually low interest rates has recently become easier to obtain in Bangladesh, unsecured working capital loans from abroad are notoriously difficult to attract. The perceived credit and political risks are high and new Basle II capital adequacy requirements make the finance unattractive to foreign lenders. Therefore, the best alternative solution is trade finance, especially export finance, which traditionally has a lower risk profile than regular, unsecured, working-capital finance. The transactions are backed by shipping documents and the underlying goods, tenors are short, and the credit risk lies with a (usually) better credit-rated buyer in a stronger economy. Bangladesh's finance risk becomes performance risk, which is manageable where the exporter has an established track record.

7.4 This chapter will bring international experience to bear on trade finance and identify instruments that could benefit small companies and new exporters. In particular, the chapter will focus on companies not part of supply chains, including the garment industry, and will discuss issues relating to general access to credit.

1 Role of Trade Finance

7.5 Much of international trade is conducted directly between firms without direct intermediation of the banking sector.⁸² Some 80 to 90 percent of total world merchandise trade, valued at US\$18 trillion in 2011, is reportedly financed between firms in a supply chain or between different units of individual

⁸² SWIFT data from http://www.swift.com/. There are substantial variations in the estimates. This estimate is assumed to exclude financing by the banking sector further up or down the supply chain.

firms. Transactions conducted directly between firms can involve cash in advance from the buyer to the seller, or be done on an "open account" basis, with the buyer paying the seller at a later point. According to messaging data from the Society for Worldwide Interbank Financial Telecommunication (SWIFT), approximately 90 percent of trade finance occurs through interfirm transactions, including "open account" exchange.⁸³ Direct cash-in-advance payments are most prevalent among micro business and SMEs in developing countries, while open-account transactions tend to be used in more developed, competitive markets.⁸⁴ In addition to making payment arrangements directly between themselves, importers and exporters have the option of using the banking sector to intermediate the transaction. Intermediation of the banking sector can provide risk mitigation, improve the liquidity and cash flow of the trading parties, and provide locally oriented firms with access to hard currency needed to finance imports.⁸⁵ Some 20-40 percent of world trade is estimated at being intermediated in this manner. The choice of direct or banking sector-intermediated trade transactions will depend on the familiarity and degree of trust between the buyer and the seller, as well as broader country, sector, and institutional factors that increase or decrease the risk of nonpayment for the goods and services being traded.⁸⁶

Figure 7.1: Trade Finance Agreements Worldwide

Figure 1. Trade Finance Arrangements Market Share of Financing Arrangements				
Open Account Cash in advance Bank Trade Finance (38% - 45%, \$6.0 - \$7.2 trillion)				llion)
19%-22% \$3 - \$3.5 trillion	35%-40% \$5.5-\$6.4 trillion	ECA Guaranteed	Arm's-Length Non-Guaranteed	Intra-Firm
\$15.9 trillion in global merchandise trade (2008 IMF estimate)				
Source: IMF Staff e	stimates, IMF-BAFT Surveys of	of commercial banl	ks, and Berne Unio	on data.

Source: Chauffour and Malouche 2011.

7.6 Trade finance generally consists of two main components, payment risk mitigation and provision of the working capital necessary for exporters and importers to manufacture or sell their goods. Working capital finance for exports is generally short term, up to 180 days, depending on the merchandise, increasing to 360 days, for example, in the case of shipbuilding. Relative to a standard credit line or working capital loan, trade finance-whether offered through banks or within the supply chain-is relatively illiquid, which means that it cannot easily be diverted for another purpose. It is also highly collateralized—credit and insurance are provided directly against the sale of specific products or services whose value can, by and large, be calculated and secured.⁸⁷ This suggests that the risk of strategic default on trade finance should be relatively low, as should be the scale of loss in the event of default.

Estimates from FImetrix (2009) suggest that 10-20 percent of trade finance is composed of cash-in-advance payments (these mainly involve SMEs, and especially in developing countries); 45-80 percent is on open account (of which 30-40 percent is intrafirm); and 10-35 percent is bank intermediated. See http://www.fimetrix.com/. ⁸⁴ Cite Chauffer and look up FImetrix, IMF-BAFT 2009).

⁸⁵ Chauffer, July 2009.

⁸⁶ Cite ICC paper.

⁸⁷ This is of course not true in all cases. Specific problems occur with products that are perishable (and whose value erodes quickly or immediately), that are extremely differentiated (where there is little or no market value outside the intended buyer), and for services (which are not generally able to be collateralized).

7.7 Exporters must offer their customers attractive sales terms supported by appropriate payment methods to win markets and be competitive (box 7.1). Because getting paid in full and on time is the ultimate goal for each export sale, an appropriate payment method must be chosen carefully to minimize the payment risk while also accommodating the needs of the buyer. As shown in figure 7.2, there are four primary methods of payment for international transactions that companies should consider during or before contract negotiations and that would be mutually desirable for both the exporter and the buyer. Exporters want to receive payment as soon as possible, preferably as soon as an order is placed or before the goods are sent to the importer. For importers, any payment is like a donation until the goods are received. Therefore, importers want to receive the goods as soon as possible but to delay payment as long as possible, preferably until after the goods are resold to generate enough income to pay the exporter.





7.8 A "confirmed" letter of credit transaction is the most prevalent instrument in trade between developed and developing countries. In a confirmed L/C transaction, a second bank (the *confirming bank*), usually in the exporter's country or region, is also involved. If an exporter is unwilling to take the payment risk of the local issuing bank, then it can request that a second bank add its commitment (or confirmation) that payment will be made to the exporter. A confirmed L/C is generally used when there is a perception that there is a risk that the local bank issuing the L/C may not fulfill its obligation to pay due to any reason, including bank failure, country instability, or country regulations. In this case, the confirming bank takes the payment risk of the local issuing bank in the country of the importer. The confirmed L/C is the most prevalent instrument among trade between developed countries and developing countries. For a confirming bank to take the payment risk of the local issuing bank, it has to establish a relationship with this bank, conduct its due diligence on the bank, and establish a prudential credit limit up to which it is willing to be exposed to this bank. As discussed below, the majority of Global Trade Finance Program (GTFP) transactions (70 percent) involve confirmed letters of credit (with the balance supporting other instruments such as pre-export and pre-import finance).

Source: US Department of Commerce 2008.

Box 7.1: International Trade Transactions Payment Methods

Cash-in-Advance. With cash-in-advance payment terms, the exporter can avoid credit risk because payment is received before the ownership of the goods is transferred. Wire transfers and credit cards are the most commonly used cash-in-advance options available to exporters. However, requiring payment in advance is the least attractive option for the buyer, because it creates cash-flow problems. Foreign buyers are also concerned that the goods may not be sent if payment is made in advance. Thus, exporters who insist on this payment method as their sole manner of doing business may lose to competitors who offer more attractive payment terms.

Letters of Credit. Letters of credit (L/Cs) are one of the most secure instruments available to international traders. An L/C is a commitment by a bank on behalf of the buyer that payment will be made to the exporter, provided that the terms and conditions stated in the L/C have been met, as verified through the presentation of all required documents. The buyer pays his or her bank to render this service. An L/C is useful when reliable credit information about a foreign buyer is difficult to obtain, but the exporter is satisfied with the creditworthiness of the buyer's foreign bank. An L/C also protects the buyer because no payment obligation arises until the goods have been shipped or delivered as promised. An L/C can be either "unconfirmed" or "confirmed." In an unconfirmed L/C transaction, an importer requests a local bank (that is, in the importer's country) to issue an L/C in favor of the exporter. The local bank (the *issuing bank*) then issues an L/C through which it irrevocably agrees to pay the exporter on agreed terms (such as presentation of relevant documents). In this transaction, there is only one bank that is financially involved—the bank that issues the L/C. The exporter takes the risk that the local issuing bank will not honor its obligations (for example, due to credit or country events). Such unconfirmed L/Cs are more common when the local issuing bank has a strong balance sheet and is in an economically and politically stable country.

Documentary collections. A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of a payment to the remitting bank (exporter's bank), which sends documents to a collecting bank (importer's bank), along with instructions for payment. Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents. D/Cs involve using a draft that requires the importer to pay the face amount either at sight (document against payment) or on a specified date (document against acceptance). The draft gives instructions that specify the documents required for the transfer of title to the goods. Although banks do act as facilitators for their clients, D/Cs offer no verification process and limited recourse in the event of nonpayment. Drafts are generally less expensive than L/Cs.

Open account. An open account transaction is a sale where the goods are shipped and delivered before payment is due, which is usually in 30 to 90 days. Obviously, this option is the most advantageous option to the importer in terms of cash flow and cost, but it is consequently the highest-risk option for an exporter. Because of intense competition in export markets, foreign buyers often press exporters for open-account terms since the extension of credit by the seller to the buyer is more common abroad. Therefore, exporters who are reluctant to extend credit may lose a sale to their competitors. However, the exporter can offer competitive open account terms while substantially mitigating the risk of nonpayment by using of one or more of the appropriate trade finance techniques, such as export credit insurance.

7.9 Recognizing the fundamental role of trade finance as an engine for global trade and the movement of goods at all stages of the supply chain, especially in emerging markets, international institutions such as the World Bank Group and regional development banks (RDBs) have programs to support trade finance in developing countries (box 7.2). The International Finance Corporation, the World Bank Group private-sector arm, has a number of programs that support trade finance, including the following:

- The Global Trade Finance Program (GTFP), which offers confirming banks guarantees covering payment risk on banks in emerging markets for trade-related transactions
- The Global Trade Supplier Finance (GTSF) program, which provides short-term finance to emerging-market suppliers and exporting SMEs
- The Critical Commodities Finance Program, which supports global agricultural commodities trade and imports of energy-related goods in the world's poorest countries

• The Global Trade Liquidity Program (GTLP), conceived to channel liquidity quickly to targeted markets by providing trade credit lines and refinancing portfolios of trade assets held by selected banks

7.10 All of these programs were scaled up during the 2008–09 financial crisis (Chauffour and Malouche 2011).

Box 7.2: The Asian Development Bank (ADB) Trade Finance Program during the 2008–09 Financial Crisis

The ADB's Trade Finance Program (TFP) provides guarantees and loans to banks in support of trade and does so within 24–48 hours from the time it receives guarantee and loan applications from partner banks. The TFP currently works with over 180 banks. The TFP has made a point of not assuming risk in India and China, preferring to focus resources on more challenging Asian markets where the private sector is not very active. The TFP had the bulk of its exposure in Bangladesh, Pakistan, and Vietnam, but was also very active in Indonesia, Sri Lanka, Nepal, Mongolia, Azerbaijan, and Uzbekistan as well as other markets. In March 2009, the ADB ramped up the activities of its TFP. The TFP supported US\$2 billion in trade, an increase of over 300 percent compared with 2008.

The program delivers tangible and measurable development impact. For example, in 2009, the TFP provided trade support for 263 small and medium-sized enterprises (SMEs). Supporting the growth of SMEs is a priority for ADB since smaller firms employ the largest number of people in most Asian countries. Increased trading activities and cross-border relationships enabled by the TFP are helping boost economic integration and cooperation in challenging Asian markets, which should, in turn, spur faster economic growth and help reduce poverty. In 2009, 56 percent of the TFP's portfolio supported intraregional trade. Furthermore, 47 percent of the TFP's 2009 US\$2 billion portfolio supported trade between ADB's developing member countries (south-south trade).

Source: Chauffour and Malouche 2011.

7.11 However, the analysis of the flow and availability of trade finance continues to be constrained by the lack of trade finance data worldwide. This limitation became evident during the 2008–09 global financial crisis as trade volumes plummeted and trade credit froze in most developing countries. As a consequence, the G20 has undertaken some initiatives to improve information on trade finance, mostly through the International Chamber of Commerce (ICC) annual and snapshot bank surveys. The Trade Finance Registry was also established by the ICC and the Asian Development Bank to capture the default and recovery rate of short-term documentary, export and import loans, and guarantees of about 19 international banks for 2005–2010. It helped show that the default and loss percentages on these trade finance instruments, even in severe economic times, were minimal. Nonetheless, comprehensive data on bank-intermediated trade finance remains unavailable. More data would help monitoring of the trade finance market, especially for low-income countries, small banks, and SMEs. It would also help make the case for the relative safety of trade finance to the Basel Committee.

2 Trade Finance in Bangladesh

7.12 Most exports from Bangladesh are based on L/Cs. Bangladesh Bank feels more comfortable with the stronger control mechanisms provided within L/C regulations. In Bangladesh, trade finance is governed by the Foreign Exchange Regulations Act 1947 (FERA) and the Foreign Exchange Guidelines of Bangladesh Bank (BB). These are updated on a regular basis through the issuance of BB circulars and other instructions. The regulations are relatively complex, especially for imports, with the aim of controlling the country's balance of payments and limiting outflows of foreign currency. As a result, all official trade passes through the local banking sector and trade financing from abroad (except through foreign bank branches) is difficult to acquire. However, the government is preparing a strategy paper to review the Foreign Exchange Regulation Act (a September 2013 benchmark) and, in particular, to lay out

a roadmap towards exchange control liberalization, assisted by IMF TA. The objective of this reform is to facilitate foreign direct and portfolio investment (IMF 2013).

7.13 Other guidelines also constrain export industries, despite some relaxation over the years. BB Export Guidelines require that title documents to export transactions be assigned in favor of a local Bangladeshi bank. This effectively prohibits the ability of offshore lenders to enter the market and provide diversified trade finance from abroad. The title documents cannot be released to the overseas buyers without the local bank first receiving payment. The restriction means that trade finance lending is almost always in Taka (in short supply during the liquidity shortage) and at the current high interest rates (up to 18 percent per year). Foreign exchange regulations have been relaxed to some extent over the years owing to lobbying by the strong garment industry, which has forced change and some simplification. Nevertheless, there remain areas where more can be done to eliminate constraints and create a more open environment.

7.14 In contrast to the above scenario, bank-intermediated trade finance accounts for only about 20 percent of total world trade. The remaining 80 percent is conducted on open-account basis or cash in advance. Of the large exporting countries in Asia, only Pakistan and Bangladesh maintain these controls. In most countries, the title documents to an export transaction are issued to order (left open) or are assigned to a specific party or foreign bank as determined in the contract between the exporter and importer. India, coming from a regulatory environment similar to Bangladesh's, successfully boosted exports through introducing open-account trading while continuing to maintain strong exchange controls. Sri Lanka also provides a good example of how the procedures have successfully been introduced.

7.15 Several private banks do provide high-quality trade finance services and the state banks, too, have improved their trade capabilities. Interviews with select banks evidenced strong management and an open approach to developing modern trade finance services. However, in FY 2011/12, the liquidity shortage restricted the banks' ability to support their clients; moreover, local banks are severely constrained by a lack of access to offshore funding. Some local banks have recently initiated cash flow lending, and take collateral only as a secondary fall-back. However, in most cases, collateral is taken for the majority of bank risk, including short-term working capital and trade finance. Sometimes security up to 150 percent of the loan is taken, together with the personal guarantees of the company's owners and directors. This places a strain on the borrower's resources, especially smaller companies. SMEs often do not have sufficient collateral available, or have assigned it to other risk. The result is they are unable to raise the finance necessary to enter the export market or increase their export business. There is a need to enhance cash flow lending among local banks, especially for trade finance, which provides lower-risk lending opportunities.

7.16 The foreign banks in Bangladesh have a number of advantages over local banks.⁸⁸ They are able to run both off-shore (U.S. dollar) and local currency balance sheets. They have easy access to US dollars from their off-shore offices. Nevertheless, the foreign banks are constrained in their overall U.S. dollar exposure by their internal country limit restrictions (table 7.1). In addition, the requirement to assign export-title documents to a local bank (discussed in detail below) does not impact the foreign banks to such an extent because they can finance a transaction from overseas, knowing the title documents are fully assigned to the local branch. Bangladeshi banks do not have this advantage.

⁸⁸ An example of a creative new import finance product was designed by a foreign bank branch in Dhaka. The bank provides post-shipment finance to importers in U.S. dollars against usance L/Cs, payable 180 days after shipment. The importer issues the usance L/C but pays the supplier at sight with the proceeds of the loan. He repays the loan after 180 days. This enables the provision of a foreign currency loan at international interest rates for the usance period. BB has authorized the foreign currency borrowing under generic approval because it is trade related. The foreign banks are already looking for more creative ways of working within the regulations.

Bank sector	Exposure (US\$ billion)	Percentage
State-owned banks	6.9	30
Privately owned banks	8.1	35
International banks (U.S. dollar)	4.4	19
International banks (local currency)	3.6	16
Total	23.0	100

 Table 7.1: Bangladesh Export Finance (2011 estimated)

Source: Author

7.17 The government has two main schemes to support SME exporters. First, the Export Refinancing Scheme (ERS) finances working capital at 10 percent per year. Under the ERS, BB no longer refinances the loans and the banks have to bear the negative interest differential themselves (10 percent versus 12 percent cost of funds). Consequently the facility is not popular with the banks and they find other ways of financing exporters at higher rates of interest. Second, the Export Development Fund (EDF) finances capital investment at 7 percent per year. Under EDF, the local banks lend to the SMEs and retain the credit risk. They refinance themselves from BB at 7 percent per year. The scheme is popular. Bangladesh's Eastern Bank commits 8 percent of its US\$1 billion export finance under the scheme (for the import of capital equipment). However the national average is believed to be lower, perhaps around 1.5 percent. There is also a Women's SME facility, which has not been well utilized so far. Nevertheless, SME exporters express a need for easier access to working capital and, where imports are required, the facility to open import L/Cs.

7.18 The lack of finance and high interest rates impact smaller companies more than their larger counterparts. SME lending is a specialized area. The risks are high, and SMEs must prove themselves before a bank can entertain lending to them. Less than half the banks in Bangladesh have SME lending as a strategic goal, although those that do have well-organized SME operations. Standard Chartered Bank has a significant SME division with 30 percent of its assets lent to SMEs. Eastern Bank and Janata Bank, among those interviewed, also have a strong SME focus. Bangladesh is a world leader in microfinance and the skills and motivation for cash flow and SME financing are improving. The average loan size for BRAC Bank (formerly the Bangladesh Rural Advancement Committee) is US\$8,000, spread across nearly a million borrowers; some of this lending supports the export industry.

7.19 The Export Credit Guarantee Scheme (ECGS) operates as Bangladesh's Export Credit Agency (ECA). The ECGS was started in 1978, based on the initiative of the Export Promotion Bureau to provide insurance against export risk. The scheme is administered by the Sadharan Bima Corporation (SBC), a state-owned general insurance company. The scheme encourages exporters to initiate exports of new products and enter new markets by covering the risk of buyer insolvency as well as political risks. The scheme also guarantees bank loans taken by exporters to meet their working capital needs prior to receiving payment from their foreign buyers. The facility provides credit up to 180 days including both pre-shipment and post-shipment finance. Coverage is 75 to 80 percent in case of commercial credit and 95 percent in case of political risks. The following trade guarantees are issued by ECGS: (i) export pre-shipment guarantees, (ii) export post-shipment guarantees, and (iii) export payment risk policy. For pre-and post-shipment guarantees, the exporters must first be accepted for credit risk by their local bank. The bank then makes the application for the guarantee to SBC. Cost of the guarantee is a low 0.10 percent, subsidized by the government for "promotional" reasons. At present, the ECGS is a rather minor department within SBC, does little business, and has a modest reputation amongst banks and exporters.

7.20 Although expansion of ECA operations can mitigate credit risk and keep trade finance markets from drying up, the potential impact of ECAs on both the financial and the real sectors of the economy

should be carefully evaluated. The choice of a sustainable business model is crucial, involving a strong governance structure as well as an adequate capital base that would allow the institution to be independent and have a strong-enough operational footprint to achieve its objectives. These are two preconditions that are seldom met in low-income economies, which often suffer from weak institutional capacity, poor governance practices, and difficulties in applying the rule of law (Chauffour et al. 2011). Examples of countries that have successfully strengthened their ECAs to good effect are Sri Lanka and Indonesia. Sri Lanka's SLECIC (Sri Lanka Export Credit Insurance Corporation) is now strongly market oriented, and supports small as well as large companies. It has been especially successful in supporting the garment industry, including small suppliers to the sector. More than 70 percent of Sri Lankan exporters are SMEs, and SLECIC has developed a number of schemes to facilitate their export operations.

3 A Modern Approach to Trade Finance

7.21 The local bank assignment requirement should be changed. This would open up Bangladesh to new trade financing structures from abroad, improve liquidity, and significantly lower financing costs. BB should allow title documents to be endorsed directly in favor of the overseas buyer in select cases. An example would be buyers that are highly rated companies and/or exporters that have a long-standing and good export performance record of, say, a minimum of three years. This would be highly beneficial to the exporter, since buyers could trade with the Bangladeshi exporter on the same terms as exporters in other countries, and acceptance of documents by the buyer would be faster and more efficient.

7.22 The risk of fraud is generally limited. One of the main concerns of BB and Bangladeshi authorities is how to ensure the correct repatriation of foreign currencies and the risk of fraud under the proposed new procedure. The risk of fraud essentially revolves around underinvoicing in order to pay reduced charges, or overinvoicing to obtain higher amounts of foreign currency out of a country than are due. Alternatively, it is conceivable goods other than those invoiced could be shipped. In all cases, fraud is extremely difficult to perpetrate. First, there are two parties to the contract, buyer and seller, and both must be willing to enter into the subversion. As most buyers of Bangladeshi ready-made garments (RMG) exports are well established companies with strong reputations, such activity would not be easy to accomplish. The buyer is always required to "accept" the invoices before a bank will purchase them. Second, in most cases, documents such as quality and standards certificates are issued, which require third parties to sign off on the goods against the invoice. Third, the goods must be processed through customs, which checks the value and quantity of goods against invoices and other documents. And finally, the shipping documents are issued by authorized agents upon loading the goods, which are again checked for quantity and content. The possibility of shipping goods other than those stipulated in the invoice is deemed near impossible.

7.23 The risk of fraud can be managed by establishing a centralized risk registry (CRR). Mortgages and charges on real estate and fixed assets can be registered at the land registry in Bangladesh. However, there does not appear to be an efficient register of pledges of moveable assets. Some institutions register the charge at the Registrar of Joint Stock Companies (RJSC⁸⁹). Other banks say this procedure is inefficient and not always complied with. Much time and effort is spent on agreeing pari-passu terms between creditors. Even if a banker does not take collateral, he will fear being subordinated to other lenders through the pledges. A CRR will include complete and accurate registration of all pledges or liens on moveable assets including receivables. This would eliminate the risk of companies financing the same export receivable more than once (through secured loans or through the sale of receivables) since financiers would be able to check existing pledge or liens on receivables. A CRR would enable potential lenders to see immediately which assets have been pledged and eliminate the possibility of fraud and

⁸⁹ Note: It is recommended that analysis be conducted of the need, either to upgrade and automate the RJSC, or establish a separate CRR.

double pledging. The issue will become more acute as off-shore trade finance becomes commonplace following the proposed change in assignment of title documents. The World Bank in Dhaka has initiated discussions on the implementation of such a register in the export processing zones (EPZs). This should be expanded to include the entire country.

7.24 IFC's new GTSF program could also be introduced to create a controlled environment under which to implement the above proposal, at least in the initial stages.⁹⁰ This would provide for a high level of comfort for BB and local authorities, because the offshore lending bank would be IFC, a triple A rated company in the World Bank Group. Under GTSF, IFC would purchase up to 100 percent of the export receivables from agreed foreign buyers of RMG and other exporters, after their acceptance of the documents, paying the net discounted amounts to the Bangladeshi exporters (through their local banks) without recourse. Since the financing is based on the (better) credit risk of the overseas buyer, discount rates would be highly competitive and represent significant cost benefits to the exporter. Implementation would typically be through an electronic platform (provided by IFC) between the buyer, the exporter, and IFC (financier). This would allow for efficient, streamlined processing since the exporter could view invoices accepted by the buyer and request financing through the platform. The GTSF could be introduced very quickly, within two months.

7.25 If even 20 percent of garment sector exports could be financed through GTSF, reducing export receivables credit delays by 45 days, this could release up to US\$350 million annually in cash flow for exporters. The program would significantly enhance liquidity in Bangladesh's financial system and substantially reduce financing costs. The change would primarily support the garment industry, because it is the largest sector, but would also assist the increasing number of other exporters in Bangladesh. Garment exporters require pre- and post-shipment finance, as most garment sales are at 60 to 90 days post-shipment credit terms (some even extending to 120 days). GTSF would provide a pre-shipment solution by discounting the receivables, improving cash flow, and reducing working capital requirements for the Bangladeshi exporters.

7.26 Exporters would greatly benefit if modern trade finance instruments such as export receivables (post-shipment finance) were widely adopted. In trade finance, export finance in particular has an especially low risk profile.⁹¹ This is because in most cases, goods exported from developing countries are sold to stronger buyers in more-developed economies where the risk is lower. The credit risk is of the buyer, and the country risk is that of the country of the buyer. In many cases the buyers are credit-worthy companies located in the United States or Europe. There is no foreign exchange risk as payment is made by the buyer in the currency of the loan. Therefore, the Bangladesh risk is reduced to performance riskthat the exporter will manufacture and ship the correct quality and quantity of goods on time. Provided the exporter has a good track record and the shipment is properly insured, the risk is manageable. Trade finance loss rates for developing countries are not significantly higher than those of developed nations. If 20 percent of Bangladesh's total exports were financed through receivables purchases, it would release up to US\$575 million annually in cash flow for manufacturers. In addition, assuming international financing costs of around 5 percent per vear compared with Bangladeshi local interest rates of nearer 18 percent per year, the overall interest rate savings would be in the region of US\$75 million per year If this is extrapolated through 2015 (assuming a conservative 10 percent per year export growth rate), working capital savings could reach US\$900 million and interest savings US\$72 million (assuming a reduced interest rate differential of 8 percent per year).

⁹⁰ The GTSF program has been approved for an overall worldwide limit of US\$500 million and it would be beneficial if Bangladesh were able to benefit from this availability.

⁹¹ Trade finance has historically had a lower default record than most unsecured bank risk.

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Box 7.3: Main Export Finance Instruments

Pre-export finance: Working capital loans made to the exporting firm, enabling it to manufacture the goods for export. The risk is structured on the strength of the export L/C or export contract. In most cases, the bank is repaid from the export proceeds in the buyer's country.

Post-shipment finance: Finance provided to the exporter to finance the post-shipment terms demanded by the buyer. Often structured in the form of purchase of export receivables, funds are paid to the exporting firm upon shipment, thereby reducing its working capital requirements. The loan is repaid by the buyer upon final payment.

Supply chain finance (SCF): SCF can include both pre- and post-shipment finance. Usually the financing would commence early in the production cycle and continue until final payment, including the post-shipment period. Finance could be provided to an exporter's supplier or the exporter, with repayment made from the final export proceeds.

Contract finance: Can also include both pre- and post-shipment finance. Finance would start upon contract signing and continue until final payment. Usually provided only to the exporter.

Factoring: The purchase of invoices (receivables) similar to the above but for smaller companies. Can be international or local.

Forfaiting: Purchase of larger, medium-term trade receivables.

7.27 A more open trade finance market should also initiate access to supply chain finance (SCF) and export contract finance (ECF). SCF can include either financing the exporter (the anchor company), enabling it to finance its suppliers, or lending to the suppliers directly, based on the strength of their orders from the anchor company. Repayment would be made from the export proceeds. In either case, the performance record of the supplier in relation to the anchor company is crucial to the supplier's ability to raise finance. A prerequisite for the success of such an instrument is the existence of organized and creditworthy companies supplying the main exporters. In Bangladesh, the delivery record of some suppliers can be uncertain, and even the well-established garment industry consists of a hub of many less credit-worthy companies supplying the main exporters. However, Bangladeshi export supply chains are relatively straightforward and it should not be long before international banks start financing the better suppliers as well as the main exporters. This would be a major step forward in providing finance to the suppliers that have proved difficult to finance in the past⁹². A simpler and more realistic means of financing exporters, at least to start with, is lending against export *contracts*. Contract finance creates liquidity for the exporter from the outset of the production cycle, (as opposed to receivables purchases, which are post shipment). This creates longer periods of finance, enabling the exporters to provide better terms to their suppliers. The mechanism would be quick to establish itself following the assignment change and would rapidly reduce working capital requirements and interest rate costs.

7.28 Small firms could benefit from local factoring.⁹³ It could provide a good means of financing the suppliers to the export industry, "the deemed exporters," as well as creating liquidity within the local economy. In other words, it could help finance the supply chain. Factoring is a method of financing small businesses that do not have easy access to regular bank finance. The factor purchases the company's invoices (receivables) at a discount, crediting the company with the net proceeds. Upon payment by the buyer, the factor pays the remaining balance to the company. In some economies, such as Portugal, Sri Lanka, and Taiwan, China, local factoring has proved to be highly successful in financing the SME sector.

⁹² IFC could provide training in SC management if Bangladesh decides to take GTSF

⁹³ International factoring requires a steady flow of sales and invoicing. If only a couple of export sales are achieved a year, it is doubtful international factoring could add much value. In addition, a Bangladeshi company exporting to a stronger buyer overseas should be able to raise more cost effective finance, as the risk in this case is that of the buyer. Therefore, international factoring is not considered to be suitable for Bangladesh.

Factoring is more costly than bank finance, especially on a nonrecourse basis, but it can help small, less credit-worthy companies obtain finance without using the banking sector. Factoring can sometimes benefit from legislation being passed to clarify the transfer of ownership of assigned receivables and the rights and obligations of the parties involved. India, for example, passed factoring legislation in 2011 that has significantly boosted factoring business. Sri Lanka, on the other hand, does not have a factoring law.

7.29 Taking these new mechanisms into consideration, the scenario suggests half of Bangladesh's exports could be financed from offshore, generating US\$3.6 billion in additional working capital by 2015. By way of comparison, consider Sri Lanka, which had total exports of US\$8.4 billion in 2011, of which approximately 52 percent comprised garment exports. It is estimated that 40 percent of total exports were financed from offshore, generating approximately US\$800 million of working capital—that is, 9.5 percent of total exports or slightly lower than the 10.3 percent estimated for Bangladesh in 2015 (table 7. 2). However, Sri Lanka has a more liquid banking system with greater access to local currency finance and lower interest rates.

Product	Total exports (US\$ billion)	Financing percentage	Finance provided (US\$ billion)	Days financed	Working capital generated (US\$ billion)
Pre-export finance		20			
Contract finance	—	12	4.2	120	1.4
Supply chain finance		8	2.8	120	0.9
Post-shipment finance		30			_
Receivables finance		20	7.0	45	0.9
Other		10	3.5	45	0.4
Total exports	35.0	50	\$17.5		\$3.6

Table 7.2: Estimated Scenario for Bangladesh Offshore Trade Finance in 2015 (US\$ billion)

Note: a. Finance provided times = days financed/360.

-- = not available.

7.30 Back-to-back (BTB) L/Cs and bonded warehouses (BWH) could largely benefit nongarment exporters. BWHs enable exporters or "deemed exporters" to import inputs without paying import duties and VAT on the materials (manufacturers must export 80 percent of their production to be able to obtain a BWH license, and BHWs may be located within or outside an EPZ). Because BWHs were initially designed solely for use by the garment industry and a few specially approved exporters, subsequent licensing seems to have been authorized on a piecemeal basis. As a result, there is uncertainty over who can obtain a license. The complexities of applying for a BWH license also constrain many small companies. Similarly, the BTB L/C scheme has been a great success in enabling SME garment suppliers to open L/Cs to import inputs without posting collateral.⁹⁴ The BTB scheme can only be used together with a BWH, and there appears to be uncertainty about who can use BWH/BTBs and who cannot. Some

 $^{^{94}}$ The "master L/C" is opened by the foreign buyer in favor of the Bangladeshi exporter. The L/C then provides the collateral upon which smaller import L/Cs can be opened by the suppliers without posting collateral. This helps increase liquidity and facilitates the production process. The master L/C can also be used as collateral for working capital loans required by nonimporting local suppliers.

major exporters stated they were unable to use BTB L/Cs because they did not export 100 percent of their production; the requirement has now been reduced to 80 percent. In the Sixth Five Year Plan, the government has extended the benefits to shipbuilding and leather industries. The uncertainty is constraining smaller companies from expanding their operations and potentially building export businesses. BTB L/Cs could also be issued without the support of a BWH. The deemed exporter would not benefit from nonpayment of import duties, but the important collateral benefits would remain.

4 **Policy Options**

7.31 Given the constraints of the local market place, there is a clear need to open the door to easier access to foreign financing. This could be achieved through a change in the local assignment requirement for export title documents. The change would enhance competition, increase liquidity, and reduce interest costs. It would be most helpful to the garment industry, because it is the largest, but would also strongly benefit Bangladesh's other exporting sectors as well as potential new exporters. In addition it would help support the SME suppliers to the export industry, which have traditionally been hard to finance.

To help achieve these aims, the following concrete policy options are proposed:

- Review Foreign Exchange Regulation Act to allow more flexible and competitive international payment mechanisms
- Change the assignment rule for export title documents.
- Phase in the new procedure by implementing IFC's GTSF program. GTSF would help introduce the above "assignment" change, at least in the initial stages, as IFC would be the "foreign financing bank."
- Implement an automated CRR. Use it to log pledges of moveable assets, thus providing clear information on all charges/pledges made by lenders. Alternatively, automate the RJSC, where charges on moveable assets are often registered.
- Make access to BTB L/Cs and BWH more transparent and broader in terms of sectors and firms (for example, deemed exporters).
- Consider introducing factoring in Bangladesh, which would be very relevant for small firms.

7.32 These recommendations should help Bangladesh modernize its trade finance business and expedite access to trade finance and working capital at more affordable and competitive rates. They would help the export sector to compete better and support its quest for expansion and diversification.

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CHAPTER 8

Attracting Foreign Direct Investment in Bangladesh

8.1 To reach East Asian growth rates of 7–8 percent, private investment levels in Bangladesh need to rise to at least 33 percent of GDP (World Bank 2012b). Foreign direct investment (FDI) could help to augment both the quality and quantity of investment. Foreign-owned firms are a source of innovation spillovers and perform significantly better than domestic firms in terms of labor productivity and profit margins. They can also help to increase the overall amount of private investment by accessing their own savings as well as international financial markets, thereby easing at least a part of Bangladesh's financial sector limitations.

8.2 The rapid rise of China and forecasts of it outsourcing 80 million jobs over the next 4-5 years due to rising wages presents an opportunity for countries like Bangladesh to attract (FDI), but this will not happen automatically. Japan, for example, is actively following a so-called 'China plus one' policy, where it is searching for alternative countries to source from. But there are several countries that could provide viable options for Japan, including, for example, Vietnam, Indonesia, etc. So far, despite being considered relatively open to FDI, capital inflows have remained small in Bangladesh. The share of FDI in GDP and private investment is low, even when compared to levels in other low-income economies. Several studies have identified the main constraints to economic growth, productivity gains, and FDI as follows: bureaucracy, corruption, electricity shortages, inadequate access to land and finance, skill shortages, ineffective implementation of measures to attract FDI inflows, and lack of confidence in sustained sociopolitical stability.⁹⁵

8.3 The benefits of FDI for economic development and export diversification are well established. A global network of multinational corporations and foreign affiliates has helped create millions of jobs, transfer technology, upgrade skills, open export markets and foster domestic competition. In the long run, FDI's most important benefits are spillovers of technology and knowledge (such as management and organizational practices) to local firms and workers, rather than easily observable things like capital inflows, jobs and taxes. Spillovers can diffuse from foreign firms to local producers within the same industry (intra-industry or horizontal spillovers) or to another industry (inter-industry or vertical spillovers). However, the impact of FDI on the host country is stronger when its linkages with the economy are high, which in turn depends on skill availability, the type of foreign ownership, the characteristics of local firms, and the host country's institutions.

8.4 This chapter reviews the main bottlenecks to overall private investment in Bangladesh, and then focuses on FDI performance and openness of Bangladesh to FDI, relying extensively on 2012 indicators from the World Bank's Investing Across Borders (IAB) initiative.⁹⁶ Although Bangladesh is one of the most open countries to foreign equity ownership, the IAB data points to the following hindrances to FDI: (i) a gap between policies and practice, (ii) lengthy and discretionary administrative procedures, (iii) weak dispute arbitration systems, and (iv) poor access to land-related information in Bangladesh. This chapter

⁹⁵ See Hossain (2008), Kafi et al. (2007), and Nasrin et al. (2010).

⁹⁶ http://iab.worldbank.org/.

also relies on UNCTAD's 2013 Bangladesh Investment Policy Review, which examines the regulatory and legal framework needed to support a bigger role for FDI in Bangladesh's economic development. In particular, the report highlights the need to examine FDI entry procedures, weaknesses in the general regime of regulations and operating conditions for business, and poor promotion of foreign investment in Bangladesh (UNCTAD 2013, forthcoming).

1 Constraints to Private Investment in Bangladesh

8.5 Investment in Bangladesh has stagnated at a relatively low level in recent years, at around 26-27 percent of GDP. This reflects feeble growth in private investment and declining public investment, to the extent that national savings could not be fully absorbed domestically. Weak incentives for investment appear to be the more binding constraints. Bangladesh has failed to improve its business environment and investment climate. The repetitive political uncertainty during election times, together with frequent general strikes and associated violence, has added to the longstanding energy and infrastructure deficits in dampening the investment climate. Deficiency of infrastructure has been a binding constraint to domestic investment, of which inadequate supply of power and gas is at the top of the list. In 2012, the demand-supply gap of electricity was around 5000 Gwh (Ministry of Finance, 2013). Bangladesh ranks last among its Asian competitors (only above Nepal) in prevalence of power outages. It was also ranked 110th in the Global Competitiveness Index 2013-14 out of 148 countries and 130 out of 189 countries in Ease of Doing Business 2014 ranking.

8.6 Deficiency of infrastructure has been a binding constraint to investment, of which inadequate supply of power and gas is at the top of the list. In 2012, the demand supply gap of electricity was around 5000 Gwh (Ministry of Finance, 2013). Chronic power shortage is a major issue. Bangladesh ranks last among its Asian competitors (only above Nepal) in prevalence of power outages One consequence is lower manufacturing productivity in Bangladesh than in Vietnam and China, and the use of costly captive generation to compensate for outages (World Bank 2012b). Bangladesh ranks last among 189 countries surveyed in World Bank's Doing Business 2014 report in terms of getting electricity connection, which takes 404 days. Transport infrastructure is also inadequate. Roads predominate as railways are inefficient and waterways and barge container transport are underutilized. Bangladesh is at a competitive disadvantage in terms of port infrastructure, paved roads, airport density, quality of air transport, and railroads. The share of paved roads in total roads in Bangladesh is some 20 percentage points below the norm after controlling for the stage of development. This is a big drawback for a country with one of the highest population densities in the world. In terms of infrastructure and institutions Bangladesh continued to rank poorly (131st and 132nd respectively out of 148) in the Global Competitiveness Index 2012-13.

8.7 Access to land is another major impediment to new investments, particularly in manufacturing. Land availability is severely limited as large unused tracts are not available. What does exist is either owned by state-owned enterprises or the government, or used for agriculture, housing and roads. Smaller firms are cut off more severely from access to land and that access has worsened over time. In 2002, 29.2 percent of firms considered it a major problem, which had risen to 41.7 percent by 2007. Unavailability of serviced land is a prominent investment hurdle (World Bank 2012b). Moreover, the property registration process is inordinately slow. According to the Bank's Doing Business Report 2014, Bangladesh ranks 177 out of 189 economies, with property registration typically taking 245 days, compared with 44 days in India, 57 days in Vietnam, 22 days in Indonesia, and only 2 days in Thailand.

8.8 Corruption, access to finance and an inefficient government bureaucracy are also extremely problematic obstacles to doing business in Bangladesh. These impose costs on doing business and hurt the country's chances to attract private investment and compete in global markets. Poor property rights protection magnifies risk perceptions; limits on user rights discourage private initiative and slow down the process of economic diversification. While many countries have improved their respective processes contract enforcement, Bangladesh has not made any significant globally-benchmarked reforms in this regard. With contract enforcement taking on average more than 1442 days, Bangladesh is slowest among

its comparator countries and ranked at 185th out of 189 countries surveyed (Doing Business 2014). Long-term lending and lending to small firms in the rural non-farm sector is inadequate. Financial depth (measured as M2-to-GDP) is quite low and the range of financial services quite rudimentary. Many of the important contractual savings institutions are absent while capital markets are extremely shallow.

8.9 Investors do not find sufficiently high return on investment also due to low human capital productivity or shortage of skills. Bangladesh lags behind competing countries in terms of educational attainment. It is unable to take full advantages of globalization with a poorly educated and relatively unskilled workforce. Firms are less able to adopt technologies from more advanced economies. Investors are less likely to try ventures that require specialist skills. While shortage of skills and low labor productivity did not constrain investment and growth in the past, it is becoming increasingly important.

2 Poor Performance of FDI Inflows in Bangladesh: A Snapshot

8.10 In the context of an unfriendly business environment, FDI has persistently been low and represented a tiny fraction of GDP and private investment in Bangladesh.⁹⁷ Bangladeshi FDI inflows reached a record high of US\$1.1 billion in 2011, but they remain below 7 percent of GDP (figure 8.1). Average FDI as a percentage of GDP was about 23 percent in the 2000s in LDCs. FDI stock as a share of GDP was also higher in comparator countries such as Vietnam (an average of 45 percent of GDP, or over 10 percent in Pakistan (despite difficult conditions there), almost 10 percent in South Asia as a whole, and 30 percent in Sub-Saharan Africa (figure 8.2).



Figure 8.1: FDI Inflows, 1990-2012, Index (1990=100)

Source: UNCTAD World Investment Report 2012 online database. http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx

⁹⁷A more detailed analysis if FDI performance in Bangladesh can be found in UNCTAD (2013, forthcoming).



Figure 8.2: Foreign Direct Investment Stock as a Share of GDP in Bangladesh and Selected Developing Countries, 2012

Source: UNCTAD World Investment Report 2012 online database. (Note: South Asia includes Iran) http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx

8.11 FDI in Bangladesh has mostly flowed into the services sector. The telecommunications industries and banking sector have attracted the most FDI, followed by the garment, gas, and petroleum sectors. Bangladesh has attracted three totally foreign-owned mobile telephone providers, as well as a majority foreign investor in the firm with the largest market share. The banking sector also includes a number of globally renowned banks. The textile and clothing industry has received less FDI, which is partially due to obstacles in this sector (UNCTAD 2013).⁹⁸ Moreover, Bangladesh has attracted investment from a diverse set of countries. Egypt was the largest foreign investor during 2005–11, with investment concentrated in telecommunications. The next largest foreign investors are the United Kingdom, the United States, and Singapore.

8.12 An important share of foreign direct investment in Bangladesh takes place in Export Processing Zones (EPZs). EPZs are export oriented industrial enclaves which provide the infrastructure, facilities, and administrative and support services for a wide variety of enterprises. Bangladesh's successful EPZs in Dhaka and Chittagong are now complemented by new EPZ developments around the country. As of December 2012, more than 350,000 jobs were created in EPZs, mostly in Chittagong and Dhaka ones (Table 8.1), although these cannot be attributed to foreign firms alone, since some domestic firms also locate in EPZs.

⁹⁸ FDI in RMG sector was restricted to EPZ until 2005 on the argument that MFA quotas were meant for Bangladeshi exporters. Though that ban was lifted, in practice, the local RMG entrepreneurs' association, BGMEA/BKMEA, which have considerable authority over export certification and registration procedures, create barriers to entry that virtually precludes FDI in the domestic RMG sector.

	No. of industries				
Name of EPZ	Manufacturing	Under implementation	- Investment (US\$ million)	Export (US\$ million)	No. of employees
Adamjee	36	27	179.41	683.47	25,470
Chittagong	170	10	1033.62	16,053.77	178,889
Comilla	32	31	163.02	799.0	13,428
Dhaka	102	11	888.46	13,395.99	86,873
Ishwardi	9	20	70.15	112.43	5,342
Karnaphuli	38	19	236.28	647.68	30,793
Mongla	16	14	6.26	159.76	1,551
Uttara	9	9	30.13	34.46	7,917
Total	412	141	2,607.33	31,886.56	350,263

 Table 8.1: Overview of EPZs in Bangladesh (Till December, 2012)

Source: Bangladesh Economic Review, 2013. www.mof.gov.bd.

8.13 Sector studies conducted for the diagnostic trade integration study (DTIS) point to the important role FDI can play in terms of export diversification and technology transfer in Bangladesh. The Republic of Korea has led investment in the garment industry. FDI was critical in the emergence of bicycle exports in Bangladesh. Malaysian investors seized an opportunity in the EU market by establishing the first bicycle exporting firm in Bangladesh in 1995. They invested US\$2 million in a new plant named Alita in Chittagong. FDI in the shipbuilding sector is close to zero for the moment; however, FDI and joint ventures could help gradually improve Bangladesh's capacity and reputation in shipbuilding, and FDI could especially help the linkage industries through technological advancement, improvement of processes as well as worker skills. Korean and Chinese investors in particular seek to capture some of the growth in Bangladesh's textiles and services sectors.

8.14 However, the most defining characteristic of the recent period of globalization has been the proliferation of global capital flows, including FDI. Between 1990 and 2011 global FDI flows expanded more than eight-fold, two and half times faster than world GDP and more than 60 percent faster than world trade growth over this period. Foreign affiliates of multinational corporations now employ 69 million workers and contribute US\$7 million in value added (UNCTAD, 2012), equivalent to more than 10 percent of all global output. FDI inflows to low and middle income countries expanded by 30 times in just 20 years, almost six times faster than they did in high income countries. As a result, the average annual share of inward global FDI flows in non OECD countries rose from 16 percent during the 1970s and 1980s to reach 45 percent in 201099. This trend has been supported by liberalization in global trade and investment regimes which, along with advances in transport and communications, have allowed multinational firms to expand their market reach, exploit resource opportunities, and offshore activities across global production networks. Moreover, FDI is becoming an increasingly significant component of output and trade in developing countries, in part due to a major expansion in the scope of global value chains (GVCs, box 8.1).

⁹⁹ It is worth noting that half of the growth in non OECD FDI over this period is accounted for by China alone.

Box 8.1: Why Do Global Value Chains Matter in the Discussion of FDI Spillovers?

Reduced policy barriers to cross-border trade and investment combined with substantial improvements in transport and communications technology have allowed for significant fragmented and geographical dispersion of production. This 'second unbundling' (Baldwin, 2012) has contributed to a major shift in global trade and investment patterns in recent decades, with production in individual countries increasingly forming just one stage in a product's value chain. The networks that have emerged from this process – typically led by large firms (normally in industrialized countries) and involving networks of suppliers across many countries in various stages (Milberg and Winkler, 2013) value addition from raw materials through component stages and to final production, assembly and delivery – are often referred to as "global value chains" (GVCs). Today, it is estimated that more than half of the value of world trade is made up of products traded in the context of GVCs. And in low income countries, particularly small ones, the vast majority of non-resource-seeking investment takes place in the context of GVCs.

But aside from their sheer scale, the context of GVCs potentially has important implications when consideration the prospects for achieving spillovers:

- Joining GVCs creates significant opportunities for spillovers through rapid insertion of host countries into global networks, but actually realizing and sustaining these spillover benefits may be mediated by governance structures of value chains (Gereffi and Fernandez-Stark, 2011) as well as the specific value chain strategies of lead firms.
- Related to the above, while GVC structures allow the potential for developing countries to participate in global trade without building up full sector-specific supply chains (Baldwin, 2012) it also means they may have little to no domestic expertise in the value chains that are investing in their country, limiting the potential for spillovers.
- In addition, GVC oriented investments have in many cases become enclaves, relatively disconnected from their host country economies. This has perhaps been aggravated by the tendency of GVC-oriented investment to be located within export processing zones (EPZs).

Thus, while many of the issues regarding spillovers are relevant for considering any type of FDI, investment under the context of GVCs raises an additional set of concerns. Understanding how these impact spillover potential and how they differ across sectoral and locational contexts is critical to considering how to maximize the potential benefits from FDI for low income countries.

Source: World Bank 2013 forthcoming.

8.15 Lessons learned from FDI policies oriented toward protected developing country markets indicate that they typically resulted in plants too small to capture economies of scale in the industry, leading to inefficient operations and expensive output. For example, in the automotive industry the import substitution strategy led to a proliferation of small assembly facilities whose output did not typically exceed 20,000 units a year, whereas economies of scale demanded output in the order of 150,000–225,000 a year. These boutique plants depended upon ongoing trade protection to keep them profitable, forcing host country consumers to pay a premium of 20–60 percent above the international market price (Moran 2006). A car assembled in 2003 at one of the mandatory joint venture plants in the protected Vietnamese market, using 10–30 percent locally produced auto parts, cost \$34,340, compared with \$16,500 for a same-size vehicle produced under free trade and investment conditions in neighboring ASEAN countries.

8.16 Import substituting FDI may generate local employment but at a very high cost and generally at the expense of local consumers. General Motors' Hungarian affiliate, by assembling 15,000 Opels behind a 22.5 percent tariff wall (before accession to the European Union in 2004 forced an end to Hungary's trade protection), created 213 jobs at a cost of more than \$250,000 each, paid for by domestic car buyers. Even learning among workers and managers and the potential to turn protected infant industries into full-scale competitive operations are limited. The parent firms delivered semi-knocked-down and completely-knocked-down "kits" to the small-scale assembly plants in the host country's protected local market. The procedures for screwing together an automobile from these car-in-a-box kits are different from assembly

procedures in world-scale plants and cannot be used as building blocks for the larger operations (Moran 2006). Cost-benefit analysis of eighty-three foreign-owned assembly and processing projects in some thirty developing countries over more than a decade, valuing all inputs and outputs at world market prices, shows that those projects oriented toward protected local markets actually subtracted from host country welfare. These industries include industrial equipment, agribusiness, textiles, pharmaceuticals, chemicals, and petrochemicals, as well as automotive equipment and electrical equipment.

8.17 To sum up, gains from FDI can be very substantial, both at the macro and micro levels, provided that FDI occurs in a competitive environment. At the macro level, gains materialize through increases in investment, employment, foreign exchange and tax revenues (Paus and Gallagher 2008). Moreover, FDI often contributes to integrate host countries into the world economy (as foreign firms are engaged in exporting and use their global sales and supply networks) and, thus, stimulates trade in the long run. FDI might also have an indirect impact on skills, infrastructure, and the business environment, as countries seeking to attract foreign investment tend to put policies in place to improve these factors. Finally, foreign entry may result in higher competition in the host country, leading to lower prices, more efficient resource allocation, and higher aggregate productivity (OECD 2002). At the micro level, FDI can benefit local suppliers directly through increased demand for quality intermediates, thus raising their output, profits, and possibly investments and labor demand. FDI can also impact directly on domestic firms that use the output of foreign firms as inputs, possibly providing access to cheaper, higher quality, and more reliable inputs (World Bank 2013 forthcoming). The coming of Suzuki to India in the late 1970s, for example, has stimulated the growth of a highly competitive automotive components industry that is now a major exporter.

3 Constraints to FDI

8.18 UNCTAD indices of FDI attraction and potential show Bangladesh to be among the underperformers.¹⁰⁰ The UNCTAD FDI Potential Index has shown two groups of economies that have attracted significantly more (or significantly less) FDI than expected on the basis of their economic determinants alone (figure 8.3). The "below-potential" group includes economies that have not traditionally relied on foreign investment for capital formation, as well as a group of developing countries with emerging market status and with growing investment potential. Underperformers include the Philippines and South Africa and, to a lesser extent, countries such as India, Indonesia, and Mexico (UNCTAD 2012).

8.19 Bangladesh should be able to triple its FDI, given its advantages and the average FDI inflows to LDCs (figure 8.2). Compared to other LDCs, Bangladesh benefits from its large domestic market, competitively-priced labor, and the powerful garment industry. These conditions should allow for increased domestic and foreign investment. Bangladesh also underperforms compared to large, populous economies such as China, India, and Indonesia, which have successfully raised per capita FDI inflows. Bangladesh's per capita FDI stock is one of the lowest among comparators (see UNCTAD 2013 for more details).

8.20 The government and the private sector link low FDI inflows to poor infrastructure and business environment. In the World Bank 2013 Doing Business database, Bangladesh ranks 129 out of 185 economies in the Ease of Doing Business. It also ranks poorly under Getting Electricity, Enforcing Contracts, and Registering Property (185, 182, and 175 respectively). According to the World Bank's Investment Climate Assessment for Bangladesh (World bank 2008), the top five investment climate constraints for metropolitan firms concerned electricity, political instability, governance, access to land, and access to finance. For nonmetropolitan firms, the top constraints were low demand for goods and services, rising inflation pressures, seasonal inaccessibility of roads, and the cost of finance. The private

¹⁰⁰ UNCTAD evaluates 177 countries in terms of their potential for FDI attraction. It takes into account market attractiveness (size, spending power, growth potential), availability of low-cost labor and skills (unit labor cost, size of manufacturing sector), presence of natural resources, and presence of FDI-enabling infrastructure (UNCTAD 2012).

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productive sector reports significant losses as a result of power scarcity. The issue is particularly detrimental to small and medium enterprises, which cannot afford generators. Manufacturing firms blame their low capacity utilization primarily on scarce electrical power.

		Above expectations	In line with	Below expectations	
	High 1st quartile	Chad, Liberia, Madagascar, Niger	Albania, Bahamas, Congo, Congo (Democratic Republic of), Equatorial Guinea, Jordan, Lebanon, Luxembourg, Mongolia, Mozambique, Zambia	Bulgaria, Ghana, Ireland, Israel, Nigeria, Norway, Panama, Turkmenistan, Uruguay	Australia, Belarus, Belgium, Brazil, Chile, China, Colombia, Hong Kong (China), Kazskhstan, Malaysia, Peru, Poland, Russian Federation, Saudi Arabia, Singapore, Switzerland, Ukraine, United Kingdom, Viet Nam
tion Index	2nd quartile	Amenia, Cambodia, Guinea, Nicaragua, Saint Vincent and the Grenadines, Solomon Islands	Costa Rica, Georgia, Honduras, Kyrgyzstan, Libya, Maldives, Malta, Namibia, Seychelles, Sudan, United Republic of Tanzania	Brunei Darussalam, Crostia, Dominican Republic, Egypt, Estonia, Iraq, Portugal, Qatar, Serbia, Tunisia, Uzbekistan	Austria, Canada, Czech Republic, France, Germany, Hungary, India, Indonesia, Mexico, Netherlands, Romania, Spain, Thailand, Turkey, United Arab Emirates, United States
PD I Attrac	3rd quartile	Antigus and Barbuda, Belize, Cape Verde, Central African Republic, Djibouti, Dominica, Fiji, Grenada, Guyana, Mali, São Tomé and Principe, Vanuatu	Barbados, Botswana, Cameroon, Lao People's Democratic Republic, the former Yugoslav Republic of Macedonia, Mauritius, the Republic of Moldova, Myanmar, Uganda, Zimbabwe	Algeria, Azerbaijan, Bolivia (Plurinational State of), Denmark, Gabon, Guatemala, Iceland, Jamaica, Latvia, Morocco, Oman, Pakistan, Syrian Arab Republic, Trinidad and Tobago	Argentina, Finland, Iran (Islamic Republic of), Italy, Japan, Korea (Republic of), South Africa, Sweden
	4th quartile	Aighanistan, Benin, Bhutan, Burkina Faso, Burundi, Comoros, Cöte d'Ivoire, Eritrea, Gambia, Guinea- Bissau, Haiti, Kiribati, Lesotho, Malawi, Mauritania, Nepal, Rwanda, Samoa, Siema Leone, Suriname, Swaziland, Togo, Tonga	Angola, Bangladesh, Bosnia and Herzegovina, El Salvador, Ethiopia, Kenya, Papua New Guinea, Paraguay, Senegal, Tajikistan, Yemen	Bahrain, Ecuador, Greece, Kuwait, Lithuania, New Zealand, Philippines, Slovakia, Slovenia, Sri Lanka	Venezuela (Bolivarian Republic of)
		4th quartile	3rd quartile	2nd quartile	1st quartile
			FDI Poten	tial Index	- The second sec

Source: UNCTAD.

Source: UNCTAD World Investment Report 2012

8.21 Estimates put the cost of electricity shortages to Bangladesh at up to two percentage points of annual GDP. Private power producers are more efficient and cost effective than state provision, which suffers from problems in governance, accountability, financial management, bad debt and collection rates, and inadequate physical capacity. Several recent initiatives have been promising: commercial losses have been reduced somewhat, financial strengthening and restructuring of power utilities is underway, and power supply reliability has improved, with some decrease in load shedding. FDI can actually play a critical role in physical infrastructure, including electricity, roads, and ports as discussed in UNCTAD 2013. Bangladesh now aims to engage with private investors, both nationals and foreigners, to help in its quest to develop its infrastructure. The current Five-Year Plan looks to private investment to substantially augment traditional public investment by utilizing the new PPP policy adopted in 2010.¹⁰¹

¹⁰¹ Infrastructure already benefits from strong technical and financial support from the multilateral banks and bilateral donors.

8.22 Measures taken by Government to address this constraint have focused on shorter-term solutions, which raise costs and subsidies and add to fiscal vulnerabilities. The Government has added 3594 MW of capacity in the last four years (Ministry of Finance, 2013). However, about 2,400 MW of this increase comes from government contracts with rental and quick rental plants (for 3-5 year terms) that run on expensive (and government-subsidized) liquid fuel. Although this strategy has helped to reduce power shortages during summer and the irrigation season in the last three years, it has further increased the power sector's dependence on the budget for large subsidy payments to these private generators. Thus, the annual budgetary transfer to the power sector was around US\$85 million per year during FY07-09, US\$140 million in FY10, US\$600 million in FY 11 and US\$815 million in FY12, the increase coinciding with the introduction of liquid fuel power plants. The annual budgetary transfer is expected to go down to about US\$600 million in FY13 due to tariff adjustments in phases since February 2011, but is not expected to reduce further unless short term rental contracts are terminated and replaced by low cost base load power plants. A number of large gas-fired/dual fuel power plants were awarded to the private sector including one large coal fired plant (1,320 MW) based on imported coal, but they are vet to even reach financial closure. It would be critical for Bangladesh to implement sustainable solutions that are able to provide unsubsidized power at competitive prices.

Serviced land is another constraint for new or expanding entrepreneurs, including foreign 8.23 investors. The cost, availability, and difficulty in procuring serviced land are cited as top issues. Land administration is divided between the Ministry of Law and the Ministry of Land, with little or no coordination. Municipal development bodies, such as the Rajdhani Unnayan Kartripakkha [Capital Development Authority] (RAJUK), also play an important role. Procedures are manual, complex, and mired in red tape and delays. Property registration and titling procedures take as long as 425 days in Dhaka. Registration fees and stamp duties are some of the highest in the region. Land and building financing is very limited for longer-term commercial mortgages. Reforms of land registration and titling and rules of usage have started; they include amendment of the Land Registration Act and undertaking the Demra (administrative subdivision in the capital Dhaka) pilot on land records computerization, which is intended for replication nationally. The digitization of 4,41,506 khatians and 4,089 mouja map-sheets have been completed covering 191 moujas under the Dhaka Metropolitan City Survey. We expect that digitization of existing mouja maps and khatians in 55 districts will be completed by June 2014. The report on digital land zoning maps of 152 upazilas in 21 districts has been prepared to secure planned and effective use of land. The digital land zoning work in 40 other districts is progressing.¹⁰² Promotion of private sector growth and the exigencies of food security are strong reasons for development of industrial and special economic zones. These zones will help balance and fulfill the land needs of both industry and agriculture.

8.24 The government enacted the Economic Zones Act in August 2010, which aims to improve, among other things, the availability of serviced land for business enterprises.¹⁰³ Most importantly, the act established an economic zones regime that is more flexible than the export processing zone (EPZ) regime. The new regime allows the private sector to develop zones under a public-private partnership (PPP) or 100 percent private model, with the eventual goal to bring all zones in the country under a single, streamlined organization. In the past, foreign companies setting up businesses inside the zones have been

¹⁰² Budget Speech 2013-14. http://www.mof.gov.bd/en/budget/13_14/budget_speech/speech_en.pdf

¹⁰³ This new act amends (i) the Bangladesh Export Processing Zones Authority Act of 1980, which was promulgated by the government to attract investment in the government-owned and operated export processing zones (EPZs); and (ii) the Private Export Processing Zones Authority (PEBZA) Act of 1996, which allows for the separate establishment of *private* EPZs and established a separate authority—the Private EPZ Cell—to administer this separate regime. (The one private EPZ, Korean EPZ, faces stiff bureaucratic resistance that prevents it from really taking off.) To date, there are eight EPZs in Bangladesh (in Adamjee, Chittagong, Comilla, Dhaka, Ishwardi, Karnaphuli, Mongla, and Uttara), the one in Chittagong EPZ being the first zone established by BEPZA in 1983. Sixty percent of factories within these EPZs are fully foreign owned.
allowed to lease the land they use. Under the new regime, it will also be possible for a foreign company to buy the land in a 100 percent private economic zone. In the new economic zones, leasing rates and utility prices will be established by the zone operators. This new, streamlined, and more comprehensible regime aims to be private sector driven and investor friendly. It will reflect the best practices and learning from other zone regimes worldwide, and will allow for investors to sell into the local market. Each new zone will be permitted to have three areas: an export processing area, a domestic processing area, and a nonprocessing area, improving the linkages between offshore and onshore companies.

8.25 With proper implementation of the new regime, economic zones could perform better in terms of job creation and attracting FDI. In FY11, the eight EPZs created employment for more than 330,000 people, contributed to 28 percent of total exports, and attracted less than 28 percent of total FDI.¹⁰⁴ In addition, most EPZs (except for Uttara and Mongla, where location presents challenges for investors) are completely or nearly sold out. In comparator countries in the region, such as the Philippines, economic zones produced 85 percent of total exports and 65 percent of total FDI. With 90 million working-age adults, Bangladesh has significant resources to improve zone performance.

Box 8.2. Benefits Offered to Foreign Investors in the Economic Zones

In addition to faster business startup and streamlined procedures through a one-stop shop, the government of Bangladesh is offering other incentives to attract foreign investors to economic zones, including the following:

- Customs duty advantages, including duty-free import of construction materials; duty-free import of machineries, office equipment, and spare parts, etc.; and duty-free import and export of raw materials and finished goods. Customs clearance is offered at the factory site. Zone developers and operators will have the same advantages as companies located inside zones.
- Fiscal and financial incentives, including facilitating profit repatriation; allowing foreign investors to keep export proceeds in foreign currency accounts; setting up banking and off-shore banking units in the zones; full repatriation of capital and dividend; relief from double taxation; exemption from dividend tax; accelerated depreciation on machinery or plant; allowing for the remittance of royalty, technical, and consultancy fees; and permitting nonresidents to open Non-Resident Foreign Currency Deposit (NFCD) accounts.
- Generalized System of Preferences (GSP) facility (in export destinations in the EU).
- Nonfinancial incentives, including 100 percent foreign ownership; most favored nation status; no ceiling on foreign and local investment; work permits issued directly by the Bangladesh Export Processing Zones Authority (BEPZA); and according residence to foreign workers.
- Investment guarantees, including operable Overseas Private Investment Corporation (OPIC) and Multilateral Investment Guarantee Agency (MIGA) schemes; and the Foreign Private Investment (Promotion and Protection) Act of 1980, which secures all foreign investment in Bangladesh.^a

Source: Authors. Note that these are what the policy promises. Actual performance or time taken may vary from case to case (e.g., time taken to repatriate profits, etc.)

Note: a. For a complete list of incentives, see http://www.epzbangladesh.org.bd/bepza.php?id=IncentivesFac.

8.26 Outside the economic zones, land-related information is scarce. Theoretically, foreign investors may obtain information on land availability from the BOI, as well as in the land registry and cadastre.

¹⁰⁴ BEPZA's website (http://www.epzbangladesh.org.bd) reports a total investment level (both domestic and foreign) of about US\$313 million for FY 2010/11, while the World Investment Report reports total FDI of US\$1.13 billion for 2011. Thus, the total investment in EPZs was 28 percent of the total FDI in Bangladesh. BEPZA does not disaggregate the US\$1.13 billion by domestic and foreign but foreign investment is estimated as somewhat less than 28 percent of total investment.

However, these two sources are not linked or coordinated to share data, although they are located in the same agency. In addition, the national land registry does not offer an inventory of public and private land plots available for greenfield FDI projects; nor does it centralize land registration data for the entire country, and all city-, municipal-, or state-level registries. There is no land information system (LIS) or geographic information system (GIS) in Bangladesh. The procedures for leasing industrial land as well as the related transaction costs are the same for foreign- and domestically-owned companies, as long as both are incorporated in Bangladesh. Before leasing public land in Dhaka, foreign companies may require approval from the BOI and Registrar of Joint Stock Companies (RJSC). Moreover, there are no restrictions on the amount of land that may be leased and the maximum duration of lease of privately owned land is 99 years. Lease contracts also offer the lessee the right to subdivide, sublease, or mortgage the leased land, or even use it as collateral. In sum, while lease rights in Bangladesh are strong, the scarcity of land continues to be a significant investment constraint.

8.27 Corruption is also a persistent problem and is frequently cited as a major constraint by investors (WEF 2012). It appears to be pervasive at all levels of government, resulting in increased costs and risks to investment. Bangladesh ranks 144 out of 176 countries on the 2012 Corruption Perceptions Index,¹⁰⁵ with a score of 2.7, lowest in the group of comparators. In addition, 85 percent of firms reported making informal payments to public officials, again the poorest record among the group of comparator countries.

8.28 While Bangladesh's manufacturing labor force is competitive and has been growing fast, it reveals a low level of productivity. Despite light labor regulations, skill shortages and mismatches impair the efficiency of the labor market. Improving labor skills requires both the strengthening of higher education and short-term vocational training measures. One promising initiative is the fully self-financed Institute of Fashion and Technology, established by the Bangladesh Garments Manufacturers and Exporters Association (BGMEA) to meet the training requirements of its industry. Furthermore, the government has supported a new initiative for building a National Vocational Skill Center. Weak innovation and low investment in technology also constrain productivity enhancements in both rural and urban areas. Innovation can be spurred by increasing both domestic and foreign competition, as firms strive for better performance and market share. Interaction with foreign firms promotes technology and other spillovers.

8.29 A shortage of skilled workers is one of the oft-cited constraints to industrialization and export growth in Bangladesh. The low level of literacy and years of schooling of the labor force make skill acquisition more difficult. About 46.5 percent of the population of the country remains illiterate, and the years of schooling among the labor force averaged 4.8 years in the year 2010. As compared to many other Asian countries, Bangladesh has a rather low level of literacy. Moreover, the education level of workers is very low compared to competing countries in the garment sector. Less schooling complicates the process of learning and skill acquisition.¹⁰⁶ (see World Bank's 2013 Education sector review including the skills constraint). Improvement in literacy rate has largely contributed to Vietnam's success stories in the last decade. The number of persons aged 15 to 24 who did not complete primary school dropped from 25 percent in 1998 to 4 percent in 2010. By 2011, Literacy rate in Vietnam was about 93 percent compared to 56 percent in Bangladesh.

 ¹⁰⁵ The Corruption Perceptions Index ranks countries and territories based on how corrupt their public sector is perceived to be. http://www.transparency.org/research/cpi/.
 ¹⁰⁶ An admittedly limited survey of 87 workers from 41 garment factories conducted in 2007 showed that a little

¹⁰⁶ An admittedly limited survey of 87 workers from 41 garment factories conducted in 2007 showed that a little over half of the workers had completed secondary education and less than 10 percent had gone beyond the tenth grade. About one-third of the workers had only primary education. The sample was drawn on the basis of proportional distribution of types of factories in the population (USAID 2007). See World Bank (2012x for more details).

8.30 Having easy access to foreign expertise can help compensate for low productivity and skill gaps, and can facilitate knowledge transfers and on-the-job professional and management training. There is also an inherent connection between expediting foreigners' work permits and attracting more FDI. The issue of work permits for foreign skilled employees is specifically relevant to foreign companies that wish to bring in domestic directors, managers, and specialist staff to set up and operate foreign affiliates. According to the Bangladesh Export Processing Zones Authority (BEPZA), the number of foreign workers in EPZs has grown about 8 percent per year between 2005 and 2011, reaching 1,575 in March 2011. Since garments account for about 90 percent of total exports from of EPZs, it can be assumed that the sector accounts for the largest share of foreign workers. BGMEA estimates that the garments sector as a whole employs about 17,000 foreign workers.¹⁰⁷ Anecdotal evidence also confirms that there is indeed a growing number of supervisory and management workers from abroad, including from India, Korea, Pakistan, Sri Lanka, and Taiwan, China.

8.31 However, the process of obtaining a temporary work permit (TWP) for foreign professionals is relatively long in Bangladesh, taking 7 to 9 weeks (officially, often takes longer in practice), including obtaining an E-category visa.¹⁰⁸ No fast-track procedure is available. In most other South Asian economies, the average permit processing time is 6 weeks. One of the fastest approval processes is in Afghanistan, where a permit can be obtained within a week. Bangladesh only issues work permits for skilled foreigners; it does not allow permits for unskilled non-Bangladeshi workers. The maximum duration of the initial TWP is two years, or up to five years with extensions. By contrast, some other South Asian economies allow unrestricted extensions of work permits.

8.32 Moreover, Bangladesh imposes quotas on skilled foreigners for both domestic and foreign companies. The ratio of foreign to local employees in an industrial enterprise cannot exceed 1:20 at any time during regular production. The foreign-to-local ratio for employees in a commercial enterprise is 1:5. Other South Asian countries generally do not impose quotas on hiring skilled foreigners. India, however, has two exceptions to the no-quota rule. The first exception applies to projects or contracts granted by Indian missions: in these cases a maximum of 1 percent of the total persons employed can be foreign, highly skilled professionals, up to maximum of 20 workers per project. The second exception applies to projects in the power and steel sector: here a maximum of 1 percent of the total persons employed can be foreign, highly skilled professionals, with a maximum of 40 workers. If additional foreigners are required, clearance from the Indian government is needed. In Bangladesh, as in most other South Asian countries, there is also no portability of TWPs. The TWP is linked to a single employer, not to a specific job category, industry, or geographic area. When the skilled foreigner wants to change employers, s/he needs to reapply for a new work permit.

8.33 The above constraints are not enough to explain why FDI has contributed so little to the Bangladeshi economy. Other low-income economies with smaller domestic markets and greater geographic isolation face similar constraints, but still have had better FDI inflows over the past decade. For example, Madagascar and Mozambique both rank poorly on Transparency International's Corruption Perception Index¹⁰⁹ and the World Bank's Doing Business indicator for Getting Electricity,¹¹⁰ but they

¹⁰⁷http://www.banglanews24.com/English/detailsnews.php?nssl=37953cab902d1f698bfb59b54d5e6369&nttl=20110 40317348 (March 24, 2011)

¹⁰⁸ The World Bank's IAB Employing Skilled Expatriates survey measures the rules and practices for obtaining temporary work permits for foreign directors and specialist staff. It also assesses the ease of accessing information concerning work permits, the possibility for expediting procedures through an official channel, restrictions concerning the composition of the Board of Directors of foreign companies and limitations on spousal work permits. See http://iab.worldbank.org

¹⁰⁹ http://www.transparency.org/research/cpi/.

¹¹⁰ http://www.doingbusiness.org/data/exploretopics/getting-electricity.

overperform on UNCTAD's FDI Attraction indicator UNCTAD 2012). Some emerging economies like Brazil and Indonesia have similar overall Ease of Doing Business rankings as Bangladesh (130 and 128 respectively). Bangladesh is actually not taking advantage of its comparative advantages for foreign investors: an abundance of competitive labor, a large domestic market, and geographic proximity to the booming Asian market. It seems that there may be other factors at play that could help explain the poor FDI inflows into Bangladesh. For example: the Korean Export Processing Zone (KEPZ) is still not being fully operational 17 years after initiation due to bureaucratic impediments. Complexity in transferring land ownership to the investors and delay in getting clearance from Department of Environment to develop industrial plot has been hampering its progress. More generally, one important question to elucidate is whether Bangladesh is actually open to FDI.

4 Is Bangladesh Really Open to FDI?

8.34 Bangladesh is often referred to as one of the most open economies in the region by international benchmarks. The World Bank 2012 Investing Across Borders initiative states that of the 32 sectors for which data was collected, only the forestry sector exhibits ownership restriction (table 8.2). In the South Asia region, India and Sri Lanka impose the most restrictions on foreign ownership (figure 8.4). Most countries impose foreign equity restrictions in the media industries, such as television broadcasting and newspaper publishing. Sectors with the least foreign ownership restrictions include oil and gas, manufacturing (such as light manufacturing, food processing, and manufacturing of basic chemicals), electricity generation from renewable sources, wireless telecommunications, higher education, courier services, accommodation, waste management, and agriculture. Electricity transmission and distribution, freight rail transportation, and, to a lesser extent, water distribution are sectors that tend to be dominated by state-owned monopolies in the region. Other international publications and guides similarly convey a message of a very welcoming stance toward FDI in Bangladesh (UNCTAD 2013).

	Afghani-	Bang-				Sri	Indo-	
Sector subgroup	stan	ladesh	India	Nepal	Pakistan	Lanka	nesia	Vietnam
Agriculture	100	100	100	100	100	100	95	100
Forestry	100	0	0	100	100	40	100	51
Mining	100	100	100	100	100	40	100	100
Oil and gas	100	100	100	100	100	100	95	100
Food processing	100	100	100	100	100	100	95	100
Manufacturing of basic	100	100	100	0	100	100	100	100
chemicals	100	100	100	0	100	100	100	100
Light manufacturing	100	100	100	100	100	100	100	100
Electric power	100	100	100	100	100	49	95	100
generation—biomass	100	100	100	100	100	-12	,5	100
Electric power	100	100	100	100	100	49	100	100
generation—solar	100	100	100	100	100	.,	100	100
Electric power	100	100	100	100	100	49	100	100
generation—wind	100	100	100	100	100	.,	100	100
Electric power transmission	49	100	100	0	100	0	95	0
Electric power distribution	49	100	100	0	100	49	95	0
Waste management and	100	100	100	100	100	100	100	100
recycling	100	100	100	100	100	100	100	100
Water distribution	100	100	100	0	100	100	100	100
Freight rail transport	49	100	0	100	100	40	49	49
Freight transport by road	100	100	100	0	100	40	49	51
Internal waterways freight transport	100	100	100	100	100	40	49	49

 Table 8.2: Maximum Shares of Foreign Equity Ownership Allowed in Various Sectors in South

 Asian Economies (Percent) 2012

Sector subgroup	Afghani- stan	Bang- ladesh	India	Nepal	Pakistan	Sri Lanka	Indo- nesia	Vietnam
International passenger air transport	100	100	49	100	49	49	49	49
Port operation	100	100	100	100	100	40	49	100
Courier activities	100	100	100	0	100	100	49	51
Accommodation services	100	100	100	100	100	100	100	100
Newspaper publishing	0	100	26	100	25	40	0	0
Television broadcasting	0	100	49	100	49	40	0	0
Fixed line telecoms infrastructure	49	100	74	100	100	100	49	49
Fixed line telecoms services	100	100	74	100	100	100	49	65
Wireless/mobile telecoms infrastructure	100	100	100	100	100	100	65	49
Wireless/mobile telecoms services	100	100	74	100	100	100	65	65
Banking	100	100	74	100	49	100	99	100
Life insurance	100	100	26	100	100	100	80	100
Health insurance	100	100	26	100	100	100	80	100
Professional services ^a	100	100	100	51	100	100	100	100
Higher education	100	100	100	100	100	100	0	100

Source: World Bank Group, Investing Across Sectors survey, 2012.

Note: a. Accounting, bookkeeping and auditing services; tax consultancy





Source: World Bank Group, Investing Across Sectors survey, 2012.

Note: The Investing Across Sectors indicators measure statutory restrictions on foreign ownership of companies in 32 sectors. Industry coverage is not exhaustive but the sectors covered capture most economic activity and account for a significant proportion of global GDP and FDI flows.

8.35 However, analysis of the main elements of the investment framework points to a situation that is more complex. The investment framework is not as unequivocally open as general policy statements

suggest. UNCTAD (2013) concludes that investors, foreign and national, operate in a challenging environment. They are confronted with major regulatory issues ranging from entry and establishment, taxation, access to skills and to land, foreign exchange regulations, corruption, and public governance. Challenges in these specific areas are compounded by a general level of complexity in the regulatory framework, a lack of clarity and transparency in regulations and procedures, and a complex institutional setup.

8.36 Moreover, nonequity barriers to FDI entry exist in multiple industries in Bangladesh. Several strategic sectors are dominated by state-owned enterprises operating as monopolies. Examples include transmission and distribution of electricity, freight rail transport, port operations, and fixed-line telecommunications infrastructure and services. Domestic companies have a considerable market share in the life and health insurance sectors, although these sectors do see modest foreign participation. While no foreign ownership restrictions appear to apply to the television broadcasting and newspaper publishing sectors, the data suggests that new entrants may experience difficulties in obtaining operating licenses

8.37 FDI is managed by a complex set of laws and regulations under various authorities. They make up for the absence of a widely encompassing law on investment, the entry, establishment, treatment, and protection of FDI.¹¹¹ The most important of these laws are as follows:

- Foreign Private Investment Promotion and Protection Act (FPIPPA, 1980)
- Investment Board Act (1989)
- Bangladesh Export Processing Zones Authority Act (1980)
- Bangladesh Small and Cottage Industries Corporation Act (1957)
- Companies Act (1994)
- Private Export Processing Zones Act (1996)
- Acquisition and Requisition of Immovable Property Ordinance (1982)
- Economic Zones Act (2010)

8.38 Sectoral laws and regulations also have an important bearing on the entry of FDI. For example, the scope and coverage of FPIPPA is quite limited, in contrast with many FDI-related laws in countries in the region and beyond. The entire act contains seven short substantive articles, covering mostly treatment, protection against expropriation, and repatriation of earnings and capital. FPIPPA remains rather vague and non-committal when it comes to entry conditions and establishment procedures (UNCTAD 2013 forthcoming).

8.39 *De facto* entry into different sectors appears very different from the picture presented in Table 8.4. Discretionary and restrictive policies are found in Bangladesh's National Industrial Policy (NIP). The various NIPs (1999, 2005, and 2010) have been a source of FDI entry restrictions. The NIP of 2010 establishes a list of 17 "controlled industries" in which the government sets maximum shares of foreign ownership and for which approval from the line ministry is required before registration with BOI, BEPZA, or the Bangladesh Small and Cottage Industries Corporation (BSCIC).¹¹² This list includes important sectors of the economy, such as banking and finance, insurance, power, natural gas and coal, large-scale infrastructure projects, telecommunications, and ports. New FDI in pharmaceuticals is not encouraged. The NIP prior to 2005 placed ready-made garments (RMG) in the reserved list of exceptional industries where FDI was not encouraged. Although this provision on RMG has since disappeared, it may partly explain the very low level of FDI in the sector, in spite of its economic significance and the importance of FDI flows in the industry in other developing countries (UNCTAD 2013). In addition, local business associations often publicly (via press articles) lobby the government to discourage FDI in

¹¹¹ As of July 2013, an investment policy has been drafted and circulated by the GoB, but not yet approved.

¹¹² A short and standard list of "reserved industries" (weapons, nuclear power, security printing and mining, logging within reserved forests) is closed to any form of private investment for national security purposes.

garments, given the capacity of local entrepreneurs to invest more if infrastructure constraints were alleviated. In telecommunications, mobile telephony is dominated by foreign investors, with multinational companies owning a majority stake in the five privately owned operators, with the sixth one under full government ownership. Yet, foreign ownership is banned in important segments of the telecommunication sector. Regulatory and licensing guidelines by the Bangladesh Telecommunication Regulatory Commission (BTRC), for example, mandate full national ownership for companies offering international gateway services, interconnection exchange services, and international internet gateway services (UNCTAD 2013).

8.40 Some activities are left in a vacuum as they cannot get BOI support and are subject to relatively dispersed entry conditions under sectoral regulations. While foreign investment approval needs to be obtained from the BOI to benefit from investment incentives such as capital repatriation and tax holidays, the mandate of the BOI is restricted to industrial undertakings. These are defined to encompass the production and processing of goods as well as the provision of certain services as defined by the government. The services considered as "industries" are enumerated in the NIP 2010 and include information technology (IT)-based activities, business process outsourcing, construction, tourism, telecommunications, transport, human resource development, and power generation. A number of services such as financial services, health, and education are not covered. BOI approval is not required when opening a branch/liaison representative office of a foreign company that has applied to the BOI for approval and registration.¹¹³ Most countries in South Asia require some form of foreign investment approval or notification. In Sri Lanka and Nepal, obtaining it takes foreign companies 6 and 53 days, respectively, while India merely requires a declaration (table 8.3).

8.41 It takes about 45 days and 10 procedures to set up a foreign-owned subsidiary engaged in foreign trade in Bangladesh. This is on par with the South Asia region. In addition to the procedures required of domestic companies, an authentication of the parent company's documentation abroad is required in order to file as a shareholder with the RJSC prior to incorporation, and the paid-up capital of the company must be remitted in a local bank and an encashment letter has to be issued. Moreover, the company is required to apply to the Chief Controller of Exports & Imports (CCIE) to obtain an Export Registration Certificate and Import Registration Certificate and to engage in international trade.

8.42 Procedures to set up a project inside an economic zone are faster. Projects in EPZs are regulated and registered separately by BEPZA. The focus of EPZs is nevertheless clearly on industrial exportoriented activities, as 100 percent of output (for a few, select industries this percentage is somewhat lower), must be exported for a business to be eligible to invest in a zone. The establishment process inside EPZs requires more procedures than setting up a similar business outside the zones; however, it is faster. Once a company is established inside the zone, there is a one-year time limit within which it has to become fully operational.

¹¹³ Bangladesh is not party to the 1961 Hague Apostille Convention that facilitates the legalization requirements of foreign public documents between states that are party to the Convention. For companies, this is especially useful as it greatly facilitates the recognition of the parent companies' documents during the registration process in a new country. Currently, 103 states are party to the Hague Apostille Convention, including most OECD countries and countries in Europe and Central Asia. In South Asia, only India is a signatory, and the Indian government has yet to enact specific legislation in that regard.

Country	Mandatory foreign investment approval or declaration details	Time (days), when required
Afghanistan	Investments of more than US\$3,000,000 are required to be approved by the High Commission on Investment.	3
Bangladesh	Foreign investment approval is only required in order to benefit from investment incentives or to establish a wholly foreign-owned branch/liaison office.	n.a.
India	Investment approvals are required for certain sectors. For manufacturing, FDI is permissible under the automatic route without prior approval from the government.	n.a.
Nepal	Foreign investors desiring to establish a wholly foreign-owned enterprise are required to apply for a foreign investment approval with the Department of Industry on a prescribed application form.	53
Pakistan	A foreign investment approval is not required unless for the establishment of a wholly foreign-owned branch/liaison office which requires the Board of Investment's approval.	n.a.
Sri Lanka	Foreign investment approval should be obtained from the Sri Lankan Board of Investment, which can take anywhere between 3 and 10 business days.	6

Table 5.5: Foreign investment Approval of Notification Kequirements in South A	pproval or Notification Requirements in South Asi
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Source: World Bank Group, Investing Across Borders Database, 2012 http://iab.worldbank.org/ *Note:* n.a. = Not applicable.

8.43 Although the existing EPZs have been moderately successful in attracting FDI and creating jobs, the new economic zones regime has been designed to be a transformational tool in attracting FDI to Bangladesh. The EZ Act 2010 laid a foundation for the expansion of economic zones with more flexible rules, especially for allowing the private sector to develop zones and enabling zone companies to sell into the local market. Following the Filipino model, where economic zones currently account for 65 percent of all FDI, Bangladesh is striving to create 15 million jobs and increase its annual growth to 10 percent over the next ten years. With technical support from the World Bank, the Government of Bangladesh has established a Jobs and Competitiveness Task Force with the mandate of converting 40,000 acres of land to economic zones enable these goals for job creation and growth. The Task Force is headed by the Prime Minister's Office and includes representatives from the Bangladesh Bank, BEZA, the BOI, and the PPP Office.

Figure 8.5: Setting Up a Foreign-Owned Subsidiary in Bangladesh



Source: Investing Across Borders Database; http://iab.worldbank.org/

5 Uneven Playing Field for Multinational Firms

8.44 Foreign investors and in particular multinational firms from advanced economies operate in an uneven playing field. The considerable degree of corruption, discretionary government decisions instead of clear regulations and procedures, and weak enforcement of standards in the domestic market affect foreign investors asymmetrically. In addition, large domestic firms that are more likely to compete with foreign firms usually have their networks and connections that help them go through the bureaucratic maze and lobby for generous treatment.

8.45 Multinationals firms often have also to abide by very strict anti-corruption laws implemented in their home countries, as well as their own codes of conduct. For example, in 1998 the United States Congress and 33 other OECD countries took action against the bribery of foreign officials, essentially government officials, in an attempt to reduce corruption and money laundering through the global financial system. Corrupt political officials and those in high army office were targeted with a view to preventing government officials from exploiting their positions to gain unfair commercial advantage. The U.S. Foreign Corrupt Practices Act (FCPA) continues to have a profound impact on the way U.S. firms undertake business at home and abroad. Any breach of the FCPA is taken as a serious offence. The penalties include being barred from tendering for U.S. government contracts, large fines, and, in some cases, criminal convictions for prosecuted company executives. Some of these convictions have resulted in jail time.¹¹⁴

Poor enforcement of standards is also a major concern for foreign investors. Sectoral analyses 8.46 conducted in the context of this study and interviews with the private sector signal a recurrent problem with the limited capacity to enforce standards in Bangladesh. According to a number of foreign firms, this often provides an advantage to domestically owned firms that are willing to cut some corners in product quality, content, or weight. Even small infringements- say, of the product being 5 percent underweight can translate to major profit differentials compared to foreign firms that are generally less likely to infringe rules and standards. Besides posing potential hazards to the consumer, lack of enforcement of standards can reduce incentives for technology transfers and quality upgrades. The pharmaceutical industry is a case in point. Interviews with the private sector, both national and multinational, indicate that the whole industry, including companies maintaining standards, suffers from the perception of noncompliance. Bangladesh's regulatory body, the Directorate General of Drug Administration (DGDA), is severely understaffed. The DGDA also lacks World Health Organization prequalification, and this favors domestic players that do not comply a hundred percent with the quality standards. The lack of proper drug testing labs and the non-availability of bio-equivalence study facilities also increase the costs of manufacturing in and exporting from Bangladesh.

8.47 In the shipbuilding industry, smaller domestic vessels are often built without application of international (class) or national (Bangladesh's Domestic Vessel Code¹¹⁵) standards. This happens for several reasons. International classification is expensive and legally not required for inland waterway and coastal vessels. Furthermore, most yards do not have the skill to produce under class standards. These vessels do have to adhere to local standards, which are enacted and enforced by the government. However, the level of these technical rules and standards is relatively low (but is it bad or suitable if

¹¹⁴ Official statistics show that 400 American firms have collectively paid US\$300 million in bribes and other questionable payments to foreign governments and political parties, including direct payments to the accounts of government officials in the mid-70s. One of the organizations involved in such bribery was a major aerospace company. Executives at this company bribed foreign officials to favor their products not only in developing countries, but also in industrialized nations including Italy, the Netherlands, and Japan. Scandals like these tested the public's confidence in the integrity of American businesses, and in 1977, the Foreign Corrupt Practices Act (FCPA) was signed into law. (www.fcpa.us).

¹¹⁵ Published in 2001 in accordance with Inland Shipping Ordinance, 1976.

enforced, see Ships chapter?), and in many cases they are not enforced. According to government officials, only three surveyors are taking care of design approvals and supervision tasks for the entire domestic fleet in Bangladesh as of mid-2012. As a result, domestic nonclassed vessels are produced at lower cost and generally at lower quality levels. A number of accidents have led to large casualties in Bangladesh.

8.48 Similarly, multinationals are increasingly under intense scrutiny from their governments and consumers on labor, safety, and environmental standards. For example, the U.S. statutory authority for the General System of Preferences program requires country-beneficiaries to adhere to a number of criteria, among them protection of specified labor rights and protection of intellectual property rights. However, even if European and American companies do need to be very careful and usually choose to work with reputable suppliers that have a strong record of providing safe and healthy work environments, and those who are meeting if not exceeding government standards throughout all aspects of their businesses.

8.49 However, the asymmetry in compliance between foreign and local firms is less of an issue since garments are sent to the export market that generally demands such compliance, and the unfortunate events of 2013 (most notably but not only the collapse of Rana Plaza that killed hundreds of workers) should serve to reduce this asymmetry further. As a result of these events, the government and major buyers in both the EU and the USA are moving quickly to adopt and enforce a much tougher set of compliance standards, dealing with both labor issues as well as building/factory standards (see chapter on Standards).

8.50 Finally, FDI is not always welcomed by domestic firms, which is not unusual in a situation where large players are well-entrenched in the market. But even garment firms, where the relevant market is exports, would prefer to direct FDI in the sector into certain segments. BGMEA reportedly urged the Ministry of Commerce and BOI to impose restrictions on foreign investments in the RMG sector. Foreign investors from China, India, and elsewhere want to benefit from Bangladesh's zero-tariff duty with the EU, agreed under GSP rules that came into effect on January 1, 2011.¹¹⁶ BGMEA also is concerned that increased FDI inflows into the sector will hurt local factories through wage inflation as foreign companies hire workers and pay them more, and the use of limited infrastructure, especially power and gaz. According to Haque (2013), leadership in the Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA) also reportedly complained that most Chinese entrepreneurs wanted to invest in the RMG sector, where local manufactures were strong enough. BKMEA apparently urged China manufacturers to invest in high-end products like spinning, the woven textile segments, and the chemical industry, as Bangladesh spends billions of taka to import 70 percent of the required fabrics and 100 percent of raw materials.

6 International Payments and Investments

8.51 The ability to convert and transfer currency abroad is a crucial component of a country's investment and trade regime. Access to foreign exchange is necessary to pay for imports, and being able to use export proceeds freely is an incentive for firms to engage in international business. The foreign exchange regime in a country is particularly important for foreign investors: the ability to freely convert local currency into foreign exchange, and then to repatriate investment returns back home, are fundamental aspects of FDI.

¹¹⁶ "We want to keep the clothing sector reserved for the local entrepreneurs and we are lobbying for it," Financial Express quoted BGMEA vice president Siddigur Rahman as saying. He claimed that FDI is unnecessary in the sector as it "is not capital-intensive." He also suggested that foreign investment should be toward the "backward divisions." linkage textiles industry supply fabric to the woven and knitwear to http://news.priyo.com/business/2011/06/18/local-investors-resent-fdi-flo-29095.html (June 18, 2011)

Bangladesh maintains significant controls concerning its foreign exchange regime. The 8.52 overarching law, the Foreign Exchange Regulation Act, was enacted in 1947. Although the law has been amended several times since then, and comprehensive guidelines on its application and implementation have been introduced,¹¹⁷ many underlying principles are out of date compared to the norms in most open economies today. For example, foreign exchange purchased by residents with local currency (taka) must generally be used for the initially stated purpose, or be reconverted back into taka. Additionally, even though many cross-border business transactions are generally approved, the law states that "no person in or resident in Bangladesh shall ... make any payment to or for the credit of any person resident outside Bangladesh^{"118} unless exemption has been given, reflecting the restrictive underlying nature of the law. Modern day transactions such as internet-based payments/receipts for purchases or services are allowed on a very limited basis. Firms cannot invest abroad without a very exhaustive approval process. A 2011 meeting of the International Chamber of Commerce Bangladesh (ICCB) called for significant reforms to Bangladesh's foreign exchange regulations. Business leaders identified capital controls preventing investment abroad by Bangladeshi entrepreneurs, and restrictions on convertibility of the taka for business purposes, as limiting beneficial trade and investment in the country (Daily Star 2011).

8.53 While OECD countries generally have no controls at all on such flows, and most developing and emerging economies do not require approvals, countries in South Asia tend to have relatively restrictive regimes for converting and transferring currency. Bangladesh's regime however appears to be on the upper end of the restrictive scale (see tables 8.4 to 8.6).

8.54 A generic problem is the scrutiny and approval process that is involved in most foreign exchange transactions, more so on the capital account. An official approval from BOI is required to bring a foreign loan into Bangladesh (table 8.4).¹¹⁹ This involves a degree of discretion, and Bangladesh Bank is also closely involved in the review of the foreign loan application. Approval is also required from the Bangladesh Bank to repatriate capital from a liquidated FDI project (except for companies that are listed on the stock exchange). Such approval requests must include audited financial statements and tax documentation. The amount of foreign exchange approved to be purchased and transferred is calculated by Bangladesh Bank based on the net asset value of the company at the time of liquidation per the documentation provided.

8.55 Outward FDI from Bangladesh is especially restricted, being subject to very close scrutiny. To date, only one local firm has been able to undertake outward FDI. This control limits Bangladeshi firms' ability to engage in international business and investment and flexibility to take unfettered decisions to enhance their growth and competitiveness.

8.56 The average time required in Bangladesh to make a dividend payment abroad is also longer than in any other country in South Asia. Within South Asia, Nepal has an official approval requirement, estimated to take 15 days. In other countries, no approval or other procedures are required by law, though internal processes of commercial banks to review the transfer request and any associated documents usually take a few days.

¹¹⁷ See: http://www.bangladesh-bank.org/aboutus/regulationguideline/foreignexchange/fegv1cont.php.

¹¹⁸ Bangladesh Foreign Exchange Regulation Act, 5(1)(a), cited from http://www.bangladeshbank.org/aboutus/regulationguideline/foreignexchange/fegv1cont.php on June 17, 2012.

¹¹⁹ The approval process from BOI to receive a foreign loan also involves some degree of discretion. When the terms of the loan are considered, loans are more likely to be approved in business sectors being promoted by the government. The foreign exchange situation in Bangladesh is taken into account in the decision whether to grant the approval.

	Inflows	Outflows	Description
Afghanistan	Open	Open	There are no legal restrictions on inward or outward FDI capital flows in Afghanistan, other than providing information for anti- money laundering purposes.
Bangladesh	Approval required	Approval required	Equity inflows may be made freely, but foreign loans require approval of the Board of Investment. Approval is also required for capital outflows from any company not listed on the stock exchange.
India	Restricted	Restricted	Equity inflows are subject to pricing guidelines for the issuance of shares. Foreign loans must be registered and must comply with term and rate requirements. Outflows of liquidated foreign investment require documentation; the sale of shares to an Indian resident must comply with securities pricing guidelines.
Nepal	Approval required	Approval required	Approval of the Department of Industries is required for equity and foreign loan inflows. Recommendation from the Department of Industries and approval from the central bank are required for FDI-related capital outflows.
Pakistan	Restricted	Restricted	Only notification is needed for equity inflows in manufacturing. Foreign loans must be documented and registered and comply term requirements. Outflows require certification that the value is appropriate, after which notification to the central bank is needed.
Sri Lanka	Approval required	Restricted	Equity inflows require documentation and must be received via a particular type of account. Foreign loans require central bank approval. Outflows of liquidated foreign investments are allowed, if made through the same account established for the inflow.

Table 8.4: Controls and Restrictions on FDI-Related Capital Inflows and Outflows in South Asian Countries

Source: World Bank Group, Converting and Transferring Currency survey, 2012 http://iab.worldbank.org/

8.57 Although Bangladesh maintains fewer restrictions on current payments than on capital flows, many payments still have documentation requirements or are subject to quantitative limits (table 8.5). Interest and principal payments on foreign loans are automatically approved, as long as the initial loan was authorized by BOI. Similarly, dividend payments abroad may be made freely. The Bangladesh Bank must be notified of each payment. While these investment-related payments may be made freely by law, private sector respondents to the Investing Across Borders survey note that the notification requirement to the Bangladesh Bank becomes an approval in practice, as authorized dealers seek the permission of the Bangladesh Bank before converting and transferring foreign exchange abroad for such payments.

8.58 Bangladesh also restricts residents' and firms ability to hold bank accounts in foreign exchange. Certain types of foreign exchange accounts are permitted automatically, such as the Exporter's Retention Quota Accounts, or a Resident Foreign Currency Account funded with foreign exchange brought in from visits abroad; but the latter type of account may not be credited with any foreign exchange earned through commercial activity. Opening foreign exchange accounts in Bangladesh for other purposes requires the approval of the Bangladesh Bank, which is reported to take between 30 and 60 days. Foreign exchange bank accounts abroad are generally not allowed for firms, except under specific circumstances (such as to temporarily receive advance export payments). Bangladesh's restrictions on holding bank accounts in foreign currency are comparable to those in other South Asian countries but stricter than those in other regions of the world.

	Investment- related payments	Other payments	Description
Afghanistan	Open	Open	There are no legal restrictions on making interest payments, dividend payments, or other current payments abroad.
Bangladesh	Restricted	Restricted	Documentation of loan repayments and dividend payments is required to be submitted to the central bank, and such transfers must be consistently made through the same commercial bank. Documentation requirements and quantitative limits exist for other current payments.
India	Restricted	Restricted	Dividend payments require documentation and must be paid via a particular type of bank account. Interest payments may be paid without approval only if they comply with the initial loan terms. Documentation of import payments is necessary, and some quantitative limits exist for other current payments.
Nepal	Approval required	Approval required	Approval of the central bank is required for an initial dividend payment; for all loan payments; and for most other current payments, unless the amount is less than some quantitative thresholds.
Pakistan	Restricted	Restricted	Documentation of dividend payments is needed, and must be made through the same authorized dealer. Loan repayments must comply exactly with the terms in the initial loan agreement. Documentation requirements or quantitative limits exist on other current payments.
Sri Lanka	Restricted	Documentat ion required	Dividend payments are allowed, if made through the same account established for the capital inflow. Loan repayments may be made as long as they comply exactly with the approved initial loan terms. Documentation is required to make any other current payments in foreign exchange.

Table 8.5: Restrictions on Foreign Exchange Payments Abroad in South Asian Countries

Source: World Bank Group, Converting and Transferring Currency survey, 2012. http://iab.worldbank.org/

8.59 Bangladesh restricts exporting firms' use of the foreign exchange they earn from their exports. Firms must repatriate all export earnings back to Bangladesh. They may keep up to 50 percent of these proceeds in foreign exchange in a specific type of bank account (known as an Exporter's Retention Quota Account), but the remaining foreign exchange must be converted into taka. All such export transactions must be carried out via a commercial bank that is an authorized dealer in Bangladesh. In the six countries covered by the survey in South Asia, only Pakistan imposes similar restrictions (table 8.6).

8.60 The authorities are preparing a strategy paper to review the Foreign Exchange Regulation Act (a September 2013 benchmark) and, in particular, to lay out a roadmap towards exchange control liberalization, assisted by IMF TA. The objective of this reform is to facilitate foreign direct and portfolio investment (IMF 2013).

	Restriction	Description
Afghanistan	No restriction	No restrictions.
Bangladesh	Repatriate and surrender	Repatriate full value of exported goods. Surrender at least 50 percent of export proceeds.
India	Repatriate	Repatriate full value of exported goods within 12 months. Repatriated foreign exchange must be kept in a particular type of bank account.
Nepal	Repatriate	All export proceeds must be repatriated. No surrender is required.
Pakistan	Repatriate and surrender	All export proceeds must be repatriated within 6 months, and immediately converted into local currency.
Sri Lanka	Restricted	Export proceeds may be kept in foreign currency abroad, but may not be used to acquire foreign capital assets.

Table 8.6: Restrictions on Export Proceeds in South Asian Countries

Source: World Bank Group, Converting and Transferring Currency survey, 2012. http://iab.worldbank.org/ *Note:* Repatriation requires firms to transfer export proceeds received abroad back to the home country. Surrender requires the firms to convert the repatriated foreign exchange into local currency.

7 Policy Recommendations

8.61 The need for FDI in Bangladesh's future growth, diversification and transition to middle income country status is beyond debate. Transfers of skills and technology are likely to take place through business linkages with domestic enterprises, leading to industrial cluster development. In addition, FDI could play a greater role in developing directly and indirectly by triggering domestic investment in the country's infrastructure to further attract FDI. UNCTAD Investment Policy Review (2013 forthcoming) elaborates on attracting FDI in physical infrastructure, including electricity, roads and ports following a specific request from the Government of Bangladesh.

8.62 Bangladesh has the potential to attract significantly higher levels of FDI in spite of the challenges it faces, but it has much work to do to turn that potential into reality. It can position itself as a competitive center for labor-intensive manufacturing, and attract efficiency-seeking FDI. Its attractions include abundant labor supply, a mastery of large-scale labor-intensive manufacturing in garments and to some extent footwear, a favorable location between two large and dynamic economies, India and China, as well as wide understanding of the English language. Preferential access to key consumer markets in developed countries makes it an attractive platform for export-seeking FDI. Its entrepreneurial private sector is another important asset that could be exploited further with a business-enabling regulatory framework in place. In addition, if Bangladesh is able to stay on its current growth path, its market size could increase quickly and attract a wave of market-seeking FDI. However, to make good this potential, it would have to address some critical constraints to FDI including availability of serviced land, the asymmetry between local and foreign firms, and also adopt a more welcoming and more pro-active stance towards FDI.

8.63 Some institutional and regulatory changes would be needed to spur the contribution of FDI to Bangladesh's economic growth and job creation. Entry conditions are subject to general FDI as well as sector regulations, which lead to discretionary administrative procedures. BOI plays a rather minimal role in the overall FDI process. A more transparent law on investment should be adopted by parliament. Also, the dispersed administration of public land makes it difficult for Bangladesh to adequately manage its holdings. While it is vital for local authorities to be involved in land management, a higher degree of coordination should be achieved at the national level to allocate public land to its most productive and essential use. This could be achieved through a coordination institution or body and the establishment of a public land database that would list all plots available for development by location, size, facilities, and other (UNCTAD 2013).

8.64 Bangladesh should adopt a more proactive and welcoming stance toward potential foreign investors, with BOI playing a key role to overcome Bangladesh's rather ambiguous attitude to FDI. FDI attraction strategy is to overcome imperfections and asymmetries in the provision of information about production possibilities in any given host economy. Foreign investors should get more administrative support early on when desiring to invest in Bangladesh, thereby reducing the hurdles and uncertainty they may face in a new environment. In place of cumbersome, highly discretionary screening of investment proposals, one-stop-shop investment promotion agencies ideally are empowered to make the approval of investment projects rapid, automatic, and transparent. To foster interministerial coordination, BOI could house staff from the relevant ministries whose duties are to troubleshoot investor ministry relations, with FDI approvals automatic if the ministry does not lodge a substantive objection within a (short) specified time period. In practice, the objective must be a genuine one-stop shop, not a one-morestop shop (Moran 2006).

8.65 The asymmetry faced by foreign firms vis-à-vis local firms in Bangladesh is a more serious issue than might appear at first sight. This is a kind of 'regulatory arbitrage' that local firms enjoy, and it will be an obstacle to attracting sustained, quality FDI. Addressing this will require an emphasis on non-discretion, and a fair and thorough enforcement of standards, for example, such that foreign firms that enforce strict compliance and standards are not penalized.

8.66 BOI should arrange more high-level investment promotion missions to large emerging economies, especially in Asia, including to Japan, China, and India. These missions should be preceded by preparatory missions to identify short-term FDI opportunities and requirements.¹²⁰ The cost of not seeking out investors may be high, as other competing countries such as Vietnam and Cambodia are aggressively pursuing Chinese and other Asian FDI. BOI missions could also target the promotion of sectors in which FDI may play a more critical role such as in shipbuilding (see chapter 9 too) and bicycles (see chapter 10 too).

8.67 Foreign exchange transactions and FDI need a bolder approach on the part of Bangladesh Bank. Outward FDI is an essential part of the modern firm's kit, and should be made easier. Making and receiving internet-based payments should be allowed, and current account transactions, such as dividends, interest payments, etc, could be speeded up with minimal hindrances. In general, the FERA needs to be overhauled in keeping with the spirit of a modern economy. The government is actually preparing a strategy paper to review the FERA (a September 2013 benchmark) and, in particular, to lay out a roadmap towards exchange control liberalization, assisted by IMF TA. The objective of this reform is to facilitate foreign direct and portfolio investment (IMF 2013).

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¹²⁰ These missions will be supported by the Private Sector Development Support Project (PSDSP), financed by the World Bank (UNCTAD 2013).

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