IMPACT OF TRADE POLICY REFORMS ON INDUSTRIAL CAPACITY AND EMPLOYMENT IN BANGLADESH

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Table of Contents

1. INTRODUCTION

In Bangladesh, as in many other developing countries in Asia, Africa and Latin America, the Structural Adjustment Programme (SAP) has been in operation since the 1980s. In fact, it can be said that Bangladesh had her first taste of adjustment lending in July 1975, although it was not called by this name at that time, when the second stand-by arrangement with the IMF was signed. Not only was Bangladesh required to devalue the Taka by 58%, other measures which were agreed between the Government of Bangladesh (GOB) and the Fund included import liberalization, tightening bank credit and raising the interest rate, reducing public borrowing from the banking system, rationalizing the tax system, reducing subsidy on food grains and agricultural inputs, and avoiding multiple currency practice (Syeduzzaman, 1991). As is well known, these are elements of a standard adjustment lending package of the Bank-Fund.

The next major adjustment programme was introduced in 1980 when Bangladesh signed an agreement with the Fund for support under the Extended Fund Facility (EFF) covering a period of three years. The EFF was aimed at supporting Bangladesh's development objectives under the Second Five Year Plan through policies and measures designed to achieve fiscal, monetary and external payments stability. The EFF was suspended in the later part of 1981 because the Fund was of the view that macroeconomic fundamentals in Bangladesh were not right, even though the GDP growth rate was 6.9% in FY 81, the highest rate achieved in the post-Liberation period. A stand-by arrangement was also negotiated with the Fund in FY 83; the basic agreement in this case was the establishment of a bench-mark for a real effective exchange rate. There was no arrangement with the IMF in FY 84 and FY 85 as the external sector performance was reasonably satisfactory. In March 1986, the IMF Board approved the Structural Adjustment Facility (SAF) for low-income countries. The Fund management was quite keen that low-income countries with balance of payments problems should take advantage of the facility. At the same time, indications were given that countries desirous of getting IDA non-

project/import credits would be well-advised to opt for the SAF, although no formal linkage was explicitly spelt out between import credits from the IDA and the SAF. Under the circumstances, Bangladesh signed her first arrangement under the SAF in FY 87, and it is from this time that structural adjustment policies are generally said to have been initiated in Bangladesh.

Since 1973 the World Bank had been supporting Bangladesh with an annual import programme credit (IPC). While the first three credits were aimed at rehabilitation of the war-ravaged economy, from the fourth IPC onwards the IDA began to address through these credits various issues pertaining to economic efficiency in different sectors. While many of the IPCs could be viewed as Sectoral Adjustment Credits, given their focus on specific sectors, others could be referred to as Structural Adjustment Credits in view of their emphasis on supporting macroeconomic and institutional reforms. IPCs used to support trade policy reforms would fall in the second category.

The fourth, fifth and sixth IPC focused on factors inhibiting the efficiency of the country's major industries. IPCs VII and VIII focused on export development, while the ninth and tenth IPC shifted the policy attention to agriculture. The objective of IPC XI, which was negotiated in 1982, was inter alia to implement policy reforms in the field of trade and industry. Considerable emphasis was placed on trade policy reform (along with reform of industrial policy) in IPC XIII. IPCs were subsequently phased out, and trade and industrial policy reforms (along with financial sector reforms) were pursued under Industrial Sector Credits.

Thus, while it is generally believed that Bank-Fund supported trade policy reforms in Bangladesh have been launched from the mid-eighties onwards, it would not be incorrect to state that such reforms have been undertaken since 1982, or even earlier (since import liberalization was part of the conditionalities associated with the second stand-by arrangement signed with the IMF in 1975). Of course, effective implementation of trade policy reform has varied from period to period.

Be that as it may, the impact of trade policy reform has been analysed and evaluated by both the World Bank and Bangladeshi scholars[1]. The objective of the present study is also to assess the impact of trade policy reform. However, the approach and methodology used in the present study are to some extent different from those adopted in the works cited above. While the above mentioned studies have used the traditional economic approach, the present endeavour has utilized the participatory method of field investigation and spliced it with the more traditional quantitative approach.

It is hoped that the use of the participatory research method will lead to a better understanding of the operation and impact of trade policy reform.

The study is organized as follows. In Section II we take a look at the genesis of trade policy reform. The aim here is to examine whether reform of trade policy was justified, given the conditions prevailing at that time. This would involve an analysis of the performance of the economy during the period FY 73 - FY 85 and the policies pursued at that juncture of history. Section II focuses on the design of trade policy reform. The major objectives here are two-fold: first, to consider the reform architecture and to ascertain whether this has undergone any change in response to performance of the economy; and second, to examine the contribution of the government in the design of trade policy reform. The actual implementation of trade policy reform is discussed in Section III. This section takes a look at the policies of import liberalization and export promotion including exchange rate reform. The impact of trade policy reform on industrial capacity is analyzed in Section V. This involves an assessment of the growth performance of the manufacturing sector, export diversification, and growth of manufactured exports. Section VI considers the impact of import liberalization on employment. Exchange rate policy is examined in Section VII. Concluding remarks are presented in Section VIII.

II. GENESIS OF TRADE POLICY REFORM

Bangladesh experienced disequilibrium in both the internal and external accounts throughout the decade of the seventies. The country had gained independence in December 1971 after a bloody ten-month long war of liberation. Consequently, the economic situation was precarious during the first three years after independence; the situation eased somewhat in the second half of the decade when the work of rehabilitating a war-ravaged economy had been completed. Large fiscal deficits were the order of the day since availability of domestic resources was much less than investment requirements. The government had no choice but to resort to deficit financing to finance rehabilitation works in the initial post- liberation period and subsequently to reinvigorate the level of economic activity in the country. As a result, money supply increased rapidly and there was very high inflation. The balance of payments position was precarious in the face of a rising import bill and low level of exports. Rising import prices, particularly of petroleum and petroleum products, and a deterioration in the terms of trade further aggravated the situation. Foreign exchange reserves were at a very low level.

The average annual growth rate of GDP for the decade of the seventies was about 5%. The average growth rate was 7.1% during FY 73 - FY 75, but it declined to 5.1% during the second half of the decade. With population growing at 2.6%, the growth of per capita income was 2.4% during the decade. Agriculture grew at 2.4% while the growth rate of manufacturing output was 7.8%. The ratio of value added in manufacturing to GDP was 10%. The domestic savings- GDP ratio rose to 3% by the end of the decade, but it was much lower than the investment - GDP ratio of 16% of that period.

The situation in the external sector was precarious. There was a chronic deficit in the current account of the balance of payments and the merchandise trade deficit increased to 10.4% of GDP by FY 80. Foreign exchange reserves were at a very low level. Imports were severely controlled in response to the unhealthy balance of payments position. A highly restrictive import regime was in operation which was characterised by extensive quantitative restrictions (QRs) and high levels of customs tariff. An import licensing system was put in place which only allowed import of commodities included in the so-called 'Positive List'; import of commodities considered as luxury or non-essential was banned. The export base was very narrow, with raw jute and jute goods accounting for about 87% of total export.

A fixed exchange rate system was in operation. The first IMF mission visited Bangladesh in March 1973 and declared that the exchange rate was over-valued and devaluation of the Taka was in order. The Government disagreed with the Fund's proposal for devaluation. Subsequently, however, the Taka was devalued under pressure from the Fund and other donors by 58% in 1975, and further devalued by about 10% in 1979.

Between 1980 and 1985, the average growth rate of real GDP was 3.5%. The real manufacturing growth rate was 5.4% in FY 81, but it declined significantly in the following four years (recording a negative growth of 0.16% in FY 83), and as a result the average growth rate of the manufacturing sector was 2.5% during the period FY 81 - FY85. The current account deficit-to-GDP ratio climbed from 10% in FY 81 to 12% in the following year, but fell subsequently to 8.2% in FY85. Total export growth was an impressive 11.4% in FY81, but it then declined to an average of about 4.5% during FY82-FY84, and registered negative growth of 3.4% in FY85. The improvement in the trade balance (i.e. reduction in the deficit) and hence a fall in the ratio of the current account deficit to GDP was largely bought about by a deceleration in the growth of merchandise imports. The movement

in the Real Effective Exchange Rate (REER) Index shows that there was real depreciation of the Taka between FY81 and FY83 by about 5.7%, but then the currency appreciated by nearly 14% in FY85 [2].

Although the major focus of the IPCs during the seventies was on improving the institutional and policy framework in the agricultural sector, by the late seventies through to the mid-eighties serious attention was paid to the manufacturing sector since, in the view of the Bank, this sector held promise but its potential could not be realised because it was straddled with various problems ranging from the dominance of state-owned enterprises (SOEs) which were inefficient and making losses to the virtual absence of an appropriate "business environment" which stifled growth of manufacturing output by failing to provide appropriate incentives for growth. The Bank found the performance of the jute, textiles, pulp and paper, and engineering industries, all of which were dominated by SOEs, particularly dis-appointing. The Bank itself diagnosed that critical shortage of key managerial and technical personnel, shortage of trained labour, frequent power failures, poor maintenance and irregular supply of inputs and spares were some of the major factors which were holding up growth of the manufacturing sector[3]. Yet, while policies were not formulated and funds made available for addressing most of the above problems, emphasis was placed on trade liberalization in the belief that regular supply of imported inputs at cheaper prices, together with competition from imports, would goad the manufacturing sector to move at a faster pace.

The experience of Bangladesh during the seventies and early eighties indicates that large fiscal deficits lay at the heart of inflation and balance-of - payments crises. The pursuit of an expansionary monetary policy exacerbated the problem. Expansionary fiscal and monetary policies led to over-valuation of the real exchange rate and this, in turn, led to increases in restrictions on imports in an effort to reduce the loss of international reserves. In other words, a growing fiscal deficit, rising inflation and worsening external balance led to the adoption of balance of payments - motivated protection. It may be noted that, conceptually, such BOP - motivated restrictions are distinct from trade restrictions imposed mainly for resource allocation purposes to affect the pattern of production.

The fiscal deficit and inflation rate should have been reduced to manageable proportions before introducing trade policy reforms in Bangladesh. The World Bank was aware of the weakness in the tax system of Bangladesh which relied heavily on customs duty and other indirect taxes. Liberalization of imports through reducing tariffs could be expected to lead to revenue loss since the demand for imports

in Bangladesh, which are mainly intermediate goods and capital machineries used in production, is relatively inelastic. In the absence of severe cuts in public expenditure, which is not only politically infeasible but also could exert an adverse effect on growth by curbing public investment, import liberalization could therefore be expected to make the task of achieving internal balance more difficult. In turn, persistence of the large fiscal deficit would put pressure on the balance of payments by fuelling inflation.

If inflation is high and variable, then relative prices are a poor guide for economic decisions. In addition, the real exchange rate is likely to appreciate and thus conflict with trade reform goals. This is indeed what may have happened in Bangladesh during the seventies and early eighties. Import liberalization had not succeeded in successfully stimulating exports. Furthermore, there were several devaluations during this period but this failed to prevent appreciation of the real exchange rate.

There were of course other factors which had inhibited a supply response to trade policy reforms. The transport, telecommunications and banking sectors were performing poorly. The regulation of financial markets was poorly managed. The desire to protect state-owned manufacturing enterprises had also probably interfered with the progress of liberalization. Infrastructural inadequacies and lack of important services like electricity, water, etc. had also constrained export supply response.

In sum, the situation prevailing in the external sector during the seventies and early eighties did call for reforming the trade regime. However, trade policy reforms should have been held back till macroeconomic stability was achieved and the supply of production-supporting services at reasonable prices was available to producers of exportables as well as import - substitutes. From this perspective it can be said that initiation of the import liberalization process in Bangladesh was premature and was not consistent with the conditions prevailing at that time.

III. DESIGN OF TRADE POLICY REFORM [4]

The impact of any reform measure would evidently depend on, among other things, its design since the objectives of reform are included therein. The designing stage is also important because it would allow the reform measure to be redesigned if it is observed that some objective (s) has not been achieved or if some new objective is to be included. Keeping this in view, the design of trade policy reform is examined below.

Trade policy reforms have been undertaken to fulfill the conditionalities attached to structural adjustment lending of the World Bank (WB) and the International Monetary Fund (IMF). The Structural Adjustment Programme (SAP) has consisted of short-term macroeconomic stabilization accompanied by fundamental structural reforms. While stabilization has been the objective of Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (SAFA) of the IMF, structural reforms have been carried out under structural adjustment loans (SALs) and sectoral adjustment loans (SECALs) of the WB. Reforms undertaken under SAP were aimed at various sectors and associated policies including fiscal policy, monetary policy, trade policy, exchange rate policy, investment policy, industrial policy, financial sector policy and public administration. It is important to note here that reforms were designed to be complementary in nature, and hence the success of reforms would depend crucially on their sequencing and timing.

The design of trade policy reform, as envisaged under SAF, ESAF, SALs and SECALs is presented in detail in Annexure Tables 1 and 2. A 3-year medium-term adjustment programme was adopted by the Government of Bangladesh (GOB) in 1986-87 under IMF's SAF and various sector adjustment and investment credits from the WB. A further 3-year programme under ESAF became effective in July 1990. The policies of the GOB were incorporated in Policy Framework Papers (PFP). It is important to note that PFPs were prepared almost entirely by the IMF and WB with negligible input from national agencies. WB's adjustment lending took the form of various sector adjustment and investment credits, viz., the SALs and SECALs.

The major objectives of IMF's adjustment lending, as reflected in the PFPs, were: achievement of efficiency in the traded goods sector, facilitating import of industrial inputs to encourage industrial production, providing free trade status for exporters, provision of export credit and encouraging growth and diversification of non-traditional exports. These objectives were to be achieved through adoption of the following strategies: rationalization of the import regime, reducing customs duty rates, reducing levels of effective protection, simplification of the tariff structure and removing special tariff concessions and exemptions, import liberalization and elimination of export subsidies.

Complementary reforms of monetary policy and financial sector reform were also included as conditionalities in IMF's adjustment lending. The major objectives of reform in this area were: interest rate liberalization, improved operation of the financial system and credit recovery, strengthening of rural

credit institutions and strengthening financial institutions. The strategies to be adopted to achieve these objectives were: interest rates to be determined by market forces, targeted programme to recover unpaid loans from loan defaulters, legal action against loan defaulters, and various measures to strengthen commercial banks. The importance of financial sector reforms for successful trade liberalization can hardly be overemphasized.

The trade policy reform objectives of WB lending (Annexure Table 2) were: liberalization and rationalization of the import regime, liberalization and rationalization of the tariff structure (including compression and reduction of rates), trade-neutral taxation, strengthening import administration, development of public capacity for protection analysis in order to provide appropriate levels of industry assistance, export promotion strategy and providing exporters with world-priced inputs. The credit conditionalities and actions to be taken by GOB in this regard were: effective protection reduced to low levels prevailing in internationally competitive developing countries, removal of import controls apart from agreed non-trade requirements, elimination of distinctions in tariff between users and between similar products, setting up a strong National Tariff Commission (NTC) which, among other things, would carry out general protection review and prepare report on industries most affected by tariff rationalization, and satisfactory operation of improved/expanded Special Bonded Warehouse scheme.

A common objective of IPCs IX - XIII during the eighties was to finance a minimum level of essential imports and thereby relieve pressure on the balance of payments. However, over the years the objective shifted to identifying and addressing what the World Bank perceived as critical issues related to production and efficiency which were faced by Bangladesh. Eventually, the focus turned to important sectoral and macroeconomic policy issues. The content and the sectoral shift of action programmes was considerably influenced by the Bank's perception regarding the political will to sincerely implement sectoral and institutional reforms. In the area of trade and industry, the aim of the IPCs was to draw the attention of the Government to major policy distortions and to emphasize the need for reforms. Many of the issues in this area called for "more intensive dialogue between the Government and the Bank and also needed more analytical work than could be undertaken within the framework of the IPCs." So the IPCs were phased out by the Bank and replaced by 'sector adjustment loans' in the latter half of the eighties.

Major trade policy reforms were being formulated by the Bank in the early eighties when a transition from a martial law regime to the civilian government of President Ziaur Rahman was accomplished. According to the Bank (World Bank, 1998), many of the Government's stated goals at this time were "wildly unrealistic" since these were based, not wholly on economic criteria, but to a large extent rooted in an attempt to placate the military, the urban middle-class and the rural rich for achieving obvious political gains. The Bank was also of the view that the country lacked the institutional capacity in the late seventies and early eighties to design a detailed multi-sector development agenda that was consistent with macroeconomic stability and the availability of external assistance. So the Bank stepped in to help Bangladesh formulate her development agenda. In the process, the Bank focussed on key, stated Government policies or objectives that were uncontroversial.

The 1982 New Industrial Policy (NIP) of GOB acknowledged the debilitating shortcomings of the prevailing industrial and trade policy regime and took steps to rectify the situation. The thrust of NIP was to develop a broader and diversified industrial and export base spearheaded by the private sector; limit the role of the public sector to strategic industries; and improve the efficiency of public sector industrial enterprises. The IPCs supported these policy measures and spelt out specific actions (in the form of conditionalities) which were to be adopted by the Government. Import liberalization was included in this policy package, and its aim was to promote private investment (along with other policy changes). Thus, import policy reforms that were undertaken in the early eighties may be considered to have been consistent with the development imperatives of the country, as perceived by the Government of that time.

It is important to remember here, however, that the Government of that period was desperately striving to achieve political legitimacy. Under these circumstances, the attractiveness of quick-disbursing programme loans which would enable the Government to relieve pressure on the balance of payments, among other things, may have clouded its judgment regarding the medium and long-term impact of import liberalization on industrial growth at a time when there was macroeconomic instability, an undeveloped financial sector, weak physical and social infrastructure, and a shortage and high prices of essential supportive services like power, transport, water, etc. Subsequently, the reform process faltered due to wavering commitment of the Government. The World Bank has observed, "The fundamental weakness with IDA assistance strategy in the early 1980s was the belief that the

Government would commit itself fully to removing the structural and institutional bottlenecks to economic growth." (World Bank, 1998).

In the mid-eighties the Bank realized that the IPCs were not effective instruments for bringing about sectoral or macroeconomic policy change. Hence IDA strategy shifted toward specific sector - type adjustment operations, with more specific and targeted policy change parameters. On the basis of past experience the Bank was convinced that it was futile to try to restructure inefficient SOEs in the absence of strong Government commitment. As a result, no further lending was envisaged to deal with these problems in the industrial sector. Rather, IDA emphasized a speedier liberalization of the trade and investment regulation regime. IDA's assistance strategy during the period 1986-1990 sought to create a more conducive environment for private sector development through inter alia reforming the trade regime.

To what extent was the policy of trade liberalization consistent with the development objectives of the country as perceived by the Ershad Government of that time? The observation of a Finance Minister of that period that, "The sectoral credits were also based on Government's own policy decisions", clearly indicates that Bank policy was in harmony with the-then Government's perception of the development imperatives of the country[5]. The industrial sector credit was designed to reflect Government's New Industrial (Revised) Policy 1986, to address problems of tariff adjustment, different aspects of trade liberalization and selective deregulation of industrial investment. The Government's perception was that this would stimulate export production and efficient import substitution, a perception which coincided with that of the Bank.

On the other hand, an evaluation study of policy-based lending of the Bank in the 1980s by the Bank itself points to "difficult dialogue" of the Bank with the Government at times during this period (World Bank, 1990). This seems to indicate that policies prescribed by the Bank were not always readily accepted by the Government, and this in turn implies that these policies, including the policy of import liberalization, may not have been in complete accord with the development aspirations of the country. This World Bank report also admits that the Government was critical about IDA's performance. The reasons for the Government's scepticism were that policy reform proposals emphasized improvements in efficiency but did not pay sufficient attention to equity aspects, and that

policy proposals on sector issues were designed in an isolated manner and were not viewed within an overall macroeconomic framework.

During the decade of the eighties, the manufacturing sector was characterized by low investment levels and considerable underutilized capacity, particularly in the large and medium-scale industries, and the average annual growth rate was only 4% . The Bank diagnosed the major causes of this unsatisfactory performance as being regulatory impediments to investment in new manufacturing activities as well as an incentive structure that favored inefficient production for a domestic market rather than for exports and efficient import substitution. Accordingly, the focus of Industrial Sector Adjustment Credit (ISAC) - 2, which was implemented in the early nineties, was to eliminate the factors that contributed to the anti-export and anti-private sector bias of the policy regime (World Bank, 1992).

The World Bank held the view that although conditionalities attached to IPCs were comprehensive, compliance by the Government was only partial. As a result, reforms were not properly implemented (World Bank, 1990). The Bank therefore decided to harden conditionalities associated with adjustment lending, and there was a sharper focus on implementation and Government commitment. The 1992 Country Strategy Paper (CSP) as well as the 1995 Country Assistance Strategy (CAS) suggested use of performance benchmarks to mark progress in the development agenda. As a result, IDA's assistance strategy in the nineties became less tolerant of delays in implementing policy reform. (World Bank, 1998). This toughening of conditionalities and close monitoring of implementation of reform measures were also felt in the trade sector. The result was an acceleration in the pace of import liberalization during the period 1991 to 1996.

There have been some major changes in the design of reforms by the World Bank in the second half of the nineties (World Bank, 1998). First, the country assistance strategy has been aligned with the Government's development goals and vision as enunciated in the Fifth Five Year Plan (1997-2002). These goals are: rapid growth with macroeconomic stability, an enabling environment for faster export-led growth spearheaded by the private sector, a reoriented public sector, and effective social programs for human development that reach the poor, particularly women and children. Second, the Bank has realized that ownership of reform and unequivocal commitment of the Government is vital for the success of the reform process. Third, it has been realized that participation of stakeholders and NGOs is a pre-condition for the success of any development programme. Accordingly, the Bank had held

extensive consultations with a range of Bangladeshi stakeholders. These included senior government officials, representatives of NGOs, trade unions, academic institutions and chambers of commerce and industry. These groups had reportedly emphasized the importance of taking a long-run view as well as the development of relevant institutions.

The Bank was convinced that poverty of institutions had constrained the successful execution of development programmes in Bangladesh in the past. Hence, institutional development formed a core strategic goal of World Bank's policy-based lending in the second half of the nineties. Building the capacity of trade-related public sector institutions (e.g., the Tariff Commission) was an important objective of Bank lending in so far as trade policy is concerned. Another major objective was the promotion of private-sector-led growth. The strategy to achieve this objective included the policy of import liberalization aimed at reducing the policy bias against exports.

It may be noted here that the private sector, in its consultation with the Bank alluded to above, had reportedly argued that trade liberalization should proceed more slowly. The Bank's subsequent espousal of a faster pace of liberalization (World Bank, 1999) indicates that the views of the major stakeholder, in so far as trade policy reform is concerned, apparently fell on deaf ears. We are not aware of the views of the senior government officers and academics on the pace of import liberalization as these have not been mentioned in the Bank document cited previously.

An examination of the strategy for development of the external sector laiddown in the Five Year Plan documents of the Government would be helpful in judging whether trade policy reforms have been consistent with the development aspirations of the country. As pointed out elsewhere[6], with the exception of the Fifth Plan (1997-2002) no other Plan had emphasized on the adoption of a policy of import liberalization with the aim of promoting exports. The First Plan adopted a policy of efficient import substitution accompanied by suitable controls on imports and foreign exchange. The Second Plan (1980-85) also adopted a policy of import substitution together with direct fiscal and other incentives to stimulate exports; there is no mention of using a policy of import liberalization to promote export development. The Third Plan (1985-90) noted with alarm the sluggish export growth and lack of any significant export diversification during the Second Plan period. The balance of payments strategy of the Third Plan however was similar to that of the Second Plan, viz., to restrict the import-export gap to the expected volume of aid inflow through controlling imports, particularly of non-essential goods. At the

same time, the strategy was to encourage exports through various promotional measures like provision of concessional credit to exporters, the Export Performance Benefit (XPB) Scheme, the Duty Drawback scheme, etc.

The Fourth Plan (1990-1995) sounded a note of caution about SAP, observing that structural adjustment is a necessary but not a sufficient condition for economic growth with social justice, which in fact was the development goal of the Government. It was of the view that the policy of import liberalization had not played any significant role in the impressive growth of export of ready-made garments, frozen food, and leather achieved during the Third Plan period. In contrast to donors' perception at that time, the Fourth Plan identified public accountability of the system as the most critical factor affecting efficiency. Like its predecessors, the Fourth Plan also proposed the adoption of fiscal and other incentives for promoting exports, advocated a policy of competitive import substitution and controlling the import of non-essential goods.

We have seen earlier that the Bank had closely monitored the implementation and impact of trade policy reforms (as well as other reforms), particularly after the phase-out of the IPCs and the introduction of industrial sector adjustment credits. On the other hand, there is little or no published evidence that the Government had monitored trade policy reform (or other reforms). There are two major annual publications of the Government which attempt to assess macroeconomic performance, viz., the Economic Review prepared by the Ministry of Finance and the Annual Report published by the Bangladesh Bank. A perusal of these two documents for various years reveals that attention has been confined to a description of facts and figures only, and they do not contain any systematic analysis of the impact of trade policy reform (or other reform processes). At the same time this implies that, in so far as the Government was concerned, the actual impact of trade policy reforms had little or no concrete feedback effect on the design of reform. The absence of any serious analysis of impact, other than those prepared by the Bank/Fund, may have seriously weakened the negotiating position of the Government in its dialogue with the donors. If this has indeed been the case, then the prevalence of donor views and perceptions relating to reform design would not at all be surprising.

To sum up, trade policy reform was almost entirely designed by the IMF and WB with negligible national input into the process. The major thrust of reform measures was to stimulate export growth through reducing and eventually eliminating the anti-export bias of trade policy. Import

liberalization was therefore adopted as a major strategy, with the objective being to reduce levels of effective protection to low levels prevailing in internationally competitive developing countries. It is important to note here that no target level of effective protection consistent with the level of Bangladesh's economic development was determined in the Bank-Fund blueprint for trade policy reform. The doners' advice to bring down effective protection levels to those prevailing in internationally competitive developing countries, presumably the East Asian "tigers" and Southeast Asian countries, reflects a perception of growth and development which ignores the socio-politico-economic peculiarities of Bangladesh. Furthermore, the possibility of differential impacts of reform on different manufacturing subsectors (according to size), with obvious implications for employment and poverty, was apparently not taken into consideration while designing trade policy reform.

The Bank and Fund had carried out assessments of the impact of trade policy reform and had concluded that any shortcoming in the performance of the tradable sector was attributable to the slow pace of reform and not to any design flaw. Hence there was no need for redesigning the reform process. On the other hand, existing published documents seem to indicate that no serious effort was made by the GOB to assess the impact of import liberalization. Consequently, no suggestion was forthcoming from GOB to alter the design of reform in the light of actual experience. It is somewhat paradoxical that although the WB had emphasized the development of a technically strong Tariff Commission for undertaking protection analysis in order to provide appropriate levels of industrial assistance, GOB has persisted in running the Tariff Commission like any other bureaucratic set-up, with the result that there has been little serious national effort to monitor and evaluate the impact of trade policy reform.

IV. IMPLEMENTATION OF TRADE POLICY REFORM

Trade policy reform has focused on elimination of QRs. rationalization of the tariff structure, simplification of import procedures, exchange rate liberalization and various measures to stimulate export growth. As noted earlier, these reforms were initiated in the early eighties with the support of the IPCs and were aimed at encouraging exports by reducing the anti-export bias of policy.

In the early 1980s Bangladesh had a very restrictive import regime characterized by pervasive QRs. Only commodities included in the 'Positive List' were permissible for import. Subsequently, the 'Positive List' was replaced by the 'Negative List' and the 'Restricted List'. Import of commodities

included in the 'Negative List' were banned while QRs and other restrictions were imposed on commodities mentioned in the 'Restricted List'. Commodities not included in these two lists could be freely imported. The two lists were subsequently merged into a single 'Control List'. The number of 4-digit H.S.Codes subject to QRs have been reduced from 478 in FY85 to 124 in FY2000.

Prior to reform, the tariff structure was characterized by high nominal rates on final products, large dispersion of these rates, and 'ad hocism' in rate fixation. Steps have been taken since 1982/83 to rationalize the tariff structure. Import duty rates have been brought down and the duty structure has been linked to the stage of production. The multiple-rated sales tax was withdrawn from many imports in 1986/87 and there was a selective reduction in tariffs on luxury goods. A phased three-year programme was undertaken in 1987/88 to further reduce net protective tariffs in the textile and steel and engineering sectors. There were 24 tariff slabs in the early eighties, but this was brought down to 11 in 1985/86, and reduced further in subsequent years.

The speed of liberalization was accelerated in the nineties. The number of QRs. has been brought down from 239 H.S. 4-digit Codes in FY91 to 124 in the Import Policy for 1997-2002; only about one-fifth of the current QRs have been imposed for trade reasons, the remaining ones being applicable on non-trade grounds like health, national security, etc. The number of banned items has been sharply reduced from 135 in FY90 to only 5 at present. The maximum tariff rate has been brought down from 350% in FY91 to 37.5% in FY2000. The number of tariff slabs currently stands at five. The tariff structure has been further compressed through reducing the number of end-user-based tariff concessions. The trade-neutral VAT was introduced in FY94 and its scope and coverage has been further extended in FY2000. A mandatory PSI system has been introduced from 20 February 2000. This will not only speed up import clearance but will also do away with the possibility of using Tariff Values as an additional protective instrument.

During the nineties direct export incentives have been further strengthened. The Special Bonded Warehouse (SBW) facility has been extended to all 100% exporters and deemed exporters. The Duty Drawback facility is in operation which allows exporters to get refund of duties/taxes paid on imported inputs. Import of raw materials and capital machinery have been made duty-free for 100% export-oriented industries. Cash compensation of 25% of f.o.b value of export is provided in lieu of duty drawback and bonded warehouse facility. Exporters also enjoy income tax rebate, tax holiday of 5-7

years or accelerated depreciation allowance at the rate of 80-100%. The ceiling for foreign currency retention by exporters has been increased to 40%. Export procedures have been simplified by allowing export without L/C but on the basis of a purchase contract, agreement, purchase order or advance payment.

Trade liberalization has increased economic openness and reduced the anti-export bias. The economic openness index (i.e., the ratio of the sum of exports and imports to GDP) has risen from 19% in FY91 to about 35% in FY99. The unweighted average customs duty rate has been reduced from 88.6% in FY91 to 16.7% in FY00. The unweighted average nominal protection rate for all tradables has declined from about 87% to 24.7% during the above period. The average effective protection rate has come down from 75.7% in FY93 to 24.5% in FY00.

World Bank (1999) has measured anti-export bias as the ratio of the effective exchange rate (EER) for imports relative to exports. The EER for imports has been derived by adjusting the nominal exchange rate for import taxes and the effect of exchange controls as reflected in scarcity premia. The EER for exports has been derived by adjusting the nominal rate to incorporate the effect of export promotion schemes. This measure is flawed to the extent that it does not take into account the effect of import taxes on inputs. Since import taxes on inputs used by export industries have been reduced at a faster rate than in the case of import-substituting industries, the World Bank methodology is likely to give an over-estimate of anti-export bias.

Using this methodology the WB has found that the policy bias in favour of producing import substitutes was about 26 percentage points in 1997-98, having declined from about 66 percentage points in 1991-92. As noted earlier, this is likely to be an over-estimate of the degree of anti-export bias. Thus, the anti-export bias has been reduced at a fairly brisk pace; furthermore, the anti-export bias cannot be said to have been substantial in 1997-98, and it is likely to have declined further by 1999-00.

The speed of import liberalization has also been faster in Bangladesh compared to South Asia as a whole, as the calculations of WB (1999) show. The ratio of post-reform average tariff to pre-reform tariff, which is a good measure of the pace of liberalization, was brought down to 0.26 in Bangladesh during 1989-98 compared to 0.40 for South Asia as a whole (between 1985 and 1998).

V. IMPACT OF TRADE POLICY REFORM ON INDUSTRIAL CAPACITY

In the absence of reliable and up-to-date data on industrial investment, growth performance of the manufacturing sector can be used as a good indicator of how industrial capacity has been affected by trade liberalization. World Bank estimates show that the average annual growth rate of the manufacturing sector during the 1980s was 3%. Table 1 shows that the overall performance of the manufacturing sector had improved in the 1990s, with an average annual growth rate of 6.6% between 1992-93 and 1998-99. At the same time, however, it may be noted from the table that a declining trend in the growth rate is discernible. More striking is the difference in growth between the large and medium scale sector and the small and cottage industry sector. Thus, while the average annual growth rate of large and medium industry during the period 1992/93-1998/99 was 8.2%, small and cottage industry grew at an average annual rate of 4.1%. A declining growth trend is however observed for large industry. Furthermore, the table also shows that overall performance of the manufacturing sector has been largely dictated by the growth of large industry, with increases and dips in the growth of large manufacturing being closely reflected in the overall growth of the manufacturing sector.

Table 1 also shows opposing trends in the shares in GDP of the large and small scale manufacturing industries. Thus, while the share of the large scale sector shows a slightly rising trend, the opposite is the case with small and cottage industry. Offsetting movements in the shares of large and small industry have resulted in a virtual stagnation of the share of the overall manufacturing sector in GDP at a little over 11% during the nineties.

These data indicate a lack of dynamism in the manufacturing sector of Bangladesh in the 1990s. Although growth rates have improved in the nineties compared to the eighties, there has been little tendency towards sustained increase in manufacturing growth in the nineties. Furthermore, the increase in manufacturing growth reflected by BBS data may to a significant extent be an exaggeration of reality (Bakht, 1995).

In Bangladesh, the annual Census of Manufacturing Industries (CMI) is the regular source of industrial statistics for medium and large industries. However, since CMI data are frequently not available on time, the BBS often resorts to the use of a quantum index of industrial production (QIP) which is based on production data collected from about one thousand enterprises. The benchmark year manufacturing GDP figure is then extrapolated from the QIP to derive constant value added estimates

for the current year. In view of the fact that since 1988/89 the coverage of the CMI has been sharply increased (to about 24 thousand units from some 4000 units) while the QIP is still calculated from more or less the same set of enterprises as before, the QIP does not accurately describe the trend in manufacturing GDP.

Bakht op. cit re-estimated the QIP using new industry weights, correcting for bias in the estimate of output growth (by revising it downward using a 'growth bias factor' estimated on the basis of the 1989-90 CMI data), and changing the base year to 1988-89. Growth rates of large and medium scale industry sector between 1990/91 and 1993/94 using the revised QIP are presented in Table 2. Comparing these growth rates with the growth rates reported in Table 1, it is found that the growth rates calculated from BBS's QIP (shown in Table 1) are considerably higher than the growth rates derived from the revised QIP (shown in Table 2). As noted earlier, the growth rate of the large and medium scale sector has heavily influenced the growth performance of the overall manufacturing sector. So, a significant diminution in the growth rate of large industry (which is indicated by the revised estimates of industrial growth presented in Table 2) implies a much lower level of manufacturing growth than the figures in Table 1 seem to indicate. In other words, while the rate of industrial growth may have improved in the nineties compared to the eighties, such improvement is in all likelihood much less striking than the growth rates derived from BBS's QIPwould lead one to believe. It may be noted here that the World Bank has used BBS's QIP in calculating growth rates of the manufacturing sector (for example, World Bank, 1999a).

Before moving on, there is another aspect of industrial growth during the nineties which should be highlighted. The overwhelming importance of the export-oriented ready-made garments (RMG) industry in the manufacturing sector of Bangladesh is well known. While more will be said about this aspect later on, at this moment it may be noted from Table 2 that the growth rate of the medium and large-scale sector is further diminished if the RMG industry is excluded. The diminution in growth rate has increased from 40% in 1990/91 to 58% in 1993/94. As is well known, the importance of the RMG industry has not declined in the post- 1993/94 period. In other words, the observed growth of the manufacturing sector in the nineties can to a large extent be tribute to growth of the RMG industry. The manufacturing growth rate declines further if another major industry, viz. pharmaceuticals, is excluded (Bakht, op. cit.).

The capital goods sector in Bangladesh is still quite undeveloped, and as a result there is a heavy dependence on imported capital machineries and equipment's. This implies that the volume of imported capital goods can be used as a good proxy measure for investment occuring in the industrial sector, particularly in the medium and large scale industry sub-sector. At the same time, the quantum and growth of imports of intermediate goods can be used as a good indicator of changes in the degree of capacity utilization in the economy.

Growth rates of imports of capital goods and intermediate inputs have been presented in Table 3. A distinction has been made between 'enclave imports' (including imports made by industries located in export processing zones) and imports made by industries located outside export enclaves. This will aid better understanding of the relative performances of industries located in export enclaves and those located outside. Table 3 shows that the growth rate of capital goods import in 1989/90 was 55.9%, while the average annual growth rate between 1990/91 and 1997/98 was about 11%. Capital goods import experienced negative growth in 1990/91, 1992/93 and 1993/94, while the growth rate was only 0.2% in 1996/97 and 3.3% in 1997/98. Import of capital goods has been disaggregated in the table into import of 'Capital machinery and parts' and 'other capital goods'. The table shows that the average annual growth rate of imports of capital machinery and parts during the period 1990/91 - 1997/98 was 11.2%, compared to a growth rate of 51.5% in 1989/90. The share of capital goods import in total import has come down from 18.7% in 1989/90 to an annual average of 16% during the nineties. These figures seem to indicate that while an increase in industrial capacity has occurred in the 1990s, this increase has not taken place in a sustained manner (with the result that the share of capital goods imports in total imports has remained more or less the same).

Table 3 also shows that the average annual growth rate of imports of intermediate inputs between 1990/91 and 1997/98 was nearly 8%, compared to the growth rate of 4.8% in 1989/90. This indicates an increase in capacity utilization during the nineties. On the other hand, the observed decline in the share of intermediate inputs import in total import between 1989/90 and 1997/98 seems to indicate that either (i) the rate of increase in manufacturing capacity utilization outside the export enclave has been lower than within the enclave or (ii) intermediate goods produced by local industries have to some extent replaced their import. The first inference is in fact supported by the rapid increase in bonded imports of fabric by the RMG industry under the back-to-back L/C system and a large increase in

imports by industries located in export processing zones, as observed from Table 3. The average annual growth rate of fabric import within the export enclave between 1990/91 and 1997/98 has been 19.6%, with a clearly discernible upward trend. The growth of import substituting industries will be examined subsequently and this will throw light on the validity of the second inference.

The growth of the percentage shares of imports of capital goods and intermediate inputs in GDP can also be used as an indicator of changes in industrial capacity and its utilization rate over time. Data pertaining to these have been presented in Table 4. It is seen that when imports of producer goods into EPZs are excluded, then the share of capital goods imports to GDP has risen from 1.75% in 1990/91 to 2.83% in 1997/98; that is, there has occurred an increase of a little over one percentage point in the share of capital goods import in GDP. It may be noted that this share actually declined from 1.99% in 1989/90 to 1.68% in 1993/94, but then began to rise in the second half of the nineties. The increase in the share of intermediate inputs has been larger, the share rising from 5.68% in 1990/91 to 9.26% in 1997/98. It may however be noted that if fabric imports under the bonded warehouse system and imports into EPZ are excluded, then the share of imported intermediate inputs in GDP is significantly lower; more importantly, this share has registered a very modest increase from 3.66% in 1990/91 to 4.83% in 1997/98.

It is important to understand whether the increase in industrial capacity and its utilization, which has been noted above, has taken place in a more a less uniform manner throughout the entire manufacturing sector or whether it has been concentrated in a few sub-sectors. Some idea about this can be formed by considering the composition of the import category 'capital machinery and parts'. The findings documented in Bhattacharya (1996) are instructive in this regard. Fifteen items at the H.S. Code 4-digit level within the sub-category 'capital machinery and parts' which together constituted about 50% of imports of capital goods between 1991/92 and 1995/96 have been listed in the above study. Two categories of capital goods were found to dominate this list and these were (a) equipment's and appliances for power generation, and (b) machineries related to textiles and ready-made garments. The second sub-category, i.e. textile related machineries, accounted for two-thirds of incremental imports between 1993/94 and 1995/96 and for 103% of the increment in imports between 1994/95 and 1995/96 (indicating that imports of machinery actually declined in some sectors in 1995/96). The importance of the textile sector in sustaining import growth of machineries during the period 1993/94 -

1995/96 is evident. The four major types of textile machineries imported during this period were: (i) machinery for producing textile yarn, (ii) weaving machines (looms), (iii) knitting machines, and (iv) sewing machines (other than book- sewing machines). These machines were used in the process of restructuring of the textile and garments industries.

A major objective of trade liberalization is to promote industrial growth through encouraging the production and export of manufactured goods. To investigate the extent to which this objective has been achieved, the pattern of growth of manufactured exports in the 1990s has been examined in Table 5. From the table it is observed that manufactured exports have grown at an average annual rate of 26.9% between 1990/91 and 1997/98, which is impressive by any measure. The table also brings out the predominance of manufactured exports in total exports, with the share of manufactured exports in total exports rising from 92.3% in 1990/91 to nearly 97% in 1997/98. Thus it is clearly seen that the growth of total exports has been propelled by the growth of manufactured exports.

How has this contributed to industrial growth ? Table 5 shows that the ratio of manufactured exports to GDP has risen from 5.2% in 1990/91 to 11.7% in 1997/98. When this ratio is compared with the ratio of total manufacturing output to GDP, it is easily seen that the importance of export-oriented manufacturing in total manufacturing activity has rapidly increased in the nineties; at the same time this implies that the share of import-substituting manufacturing output in total manufacturing output has rapidly declined over time. While the growth of export-oriented industrialization is undoubtedly a desirable outcome, it is pertinent to enquire the degree of dispersion among industrial sectors which has occurred in this process. Table 5 provides part of the answer to this question, while Table 6 throws some more light on the issue. From Table 5 it is seen that the share of ready-made garments (woven as well as knit) in total manufactured exports has climbed from 54.6% in 1990/91 to 75.8% in 1997/98. This indicates that export-oriented manufacturing activity has been concentrated in the ready-made garments sector, with a secular increase in this concentration. As a consequence of this development, the share of woven and knit garments in total export has increased from 50.5% to 73.3% between 1990/91 and 1997/98.

From Table 5 it was noted that while manufactured exports have grown at an impressive rate during the 1990s, most of this growth has been confined to the garments sector. An examination of the data presented in Table 6 shows that one major non-garment manufactured export, viz. jute textile, has

experienced negative output growth while tea and leather production has witnessed sluggish growth. Between 1991/92 and 1997/98, production of jute textiles has declined by 1.3%. During the same period, the average annual growth rate of tea production has been 2.5%, while tanning and finishing leather output has grown at 1.4%. In the case of fish and seafood, the average annual growth rate during the above period has been 1.6%. By contrast, garments have grown at the remarkable rate of 20% per annum. Recalling that the quantum index of production of the BBS is biased upward, it can be said that growth of the tea, leather and seafood industries have been weak and sluggish during the nineties.

It has already been inferred above from an analysis of data presented in Table 5 that the share of import-substituting industries in total manufacturing output has declined secularly in the 1990s. Some supporting evidence in this regard has been presented in Table 7. The table shows that some major import-substituting industries, viz., cotton textile, sugar and paper have experienced regression in the nineties. During the period 1991/92-1997/98, production of cotton textile, sugar and paper have shrunk by 24.2%, 14.8% and 48.0% respectively. By contrast, pharmaceuticals, 'bidi' cigarettes, re-rolling mills, soap and detergent, and silk and synthetic have experienced healthy average annual growth rates of 13.6%, 11.3%, 8.4%, 36%, 8.4% and 17.2% respectively. On the other hand, the fertilizer industry has grown at the modest rate of 2.4% per year. The contraction of cotton textile (industry weight =7.83), sugar (industry weight = 2.78) and paper (industry weight = 2.26), together with modest growth of fertilizer (industry weight =11.34), have doubtlessly contributed to the inferred decline in the share of import-substituting industries in total manufacturing output.

One other thing needs to be noted. Earlier it was pointed out that spinning and weaving textile machineries were important imports during the first half of the nineties, reflecting creation of new capacities in the spinning and weaving sub-sectors. Apparently this seems to conflict with the data presented in Table 7 which shows a contraction of output of both cotton yarn and cotton cloth; the contraction has been much sharper for cloth (82.6%) than for yarn (12.6%). The conflict is resolved by noting that several new spinning and composite mills were set up in the private sector in the early nineties; these mills accounted for the import of textile machineries noted above. On the other hand, production levels had declined in most of the public sector textile mills, many of which are in the process of being privatized. The decline in the production levels of public sector textile mills have more than offset the production of private sector mills with the result that total output has declined. Yarn produced

by private sector mills has more effectively competed with imports than the cloth produced by them, and as a result domestic fabric production has shrunk more sharply than domestic yarn production.

To sum up the discussion uptil now, the average annual growth rate of the manufacturing sector as a whole has more than doubled in the 1990s to 6.6% compared to the 3% annual growth achieved during the 1980s. Given the nature of BBS data on the manufacturing sector, it has been argued that the growth rate cited above is an over-estimate of actual growth that has occurred. In other words, the average growth rate is likely to have been significantly less than 6.6% quoted above. Furthermore, this growth has been confined largely to the medium and large scale industry sector; average growth of the small and cottage industry sector has been a little over 4% per year. Within the medium and large scale sector, growth of export-oriented industries have predominated, most notably woven and knit garments. While some import substituting industries have recorded satisfactory growth, notably pharmaceuticals and re-rolling mills, some others like cotton textile, sugar and paper have experienced regression. Using import of capital goods as a proxy for creation of new capacity, it has been found that while industrial capacity has increased in the 1990s, such increase has not occurred in a sustained manner. Moreover, the increase in industrial capacity which has taken place has to a large extent been limited to the textile and apparel sector; in the textile sector, new capacity created in the private sector has been offset by underutilization of existing capacity in the public sector with the result that production of the cotton textile industry has contracted in the nineties.

The important question that remains to be answered is : what is the relationship, if any, between trade liberalization and the developments in the industrial sector noted above ? The RMG centric growth of the manufacturing sector has been noted. To what extent has trade liberalization been responsible for the growth of the garments industry ? There is no doubt that the availability of duty-free inputs, notably fabric, has helped the RMG sector to flourish by enhancing the competitiveness of its products in the international market. The procedure of duty-free import of fabrics and other garments accessories under back-to-back L/C into special bonded warehouses or the procedure of refunding duties paid on imported inputs used in producing garments have evolved within the policy framework of trade liberalization. To this extent, trade liberalization has indeed stimulated the growth of the RMG industry. However, the related question that needs to be answered here is: should the procedure of duty-free import of inputs be treated as a part of the general policy of trade liberalization or should it be treated as

a sector-specific export incentive ? If duty-free import of inputs is considered as a selective, sector-specific export incentive, then it is difficult to conclude that trade liberalization has stimulated growth of the RMG industry by reducing anti-export bias through a phased reduction of import duties. More importantly, it is almost universally accepted that the MFA quota system and availability of cheap labour have been primarily responsible for the growth of RMG exports from Bangladesh. The MFA quota system had restrained exports from major garments producing countries, and this had resulted in the relocation of import supply to countries like Bangladesh which had low wage rates. Subsequently, the growth of the Bangladesh garments industry has also been sustained by the MFA quota system. Access to duty-free inputs has certainly helped this process by making Bangladesh's exports competitive.

How has trade liberalization affected the growth of other non-garments export industries and import-substituting industries? Trade liberalization is expected to stimulate export-oriented industrial growth by reducing the anti-export bias through lowering the effective rate of protection (ERP) provided to an activity. So, an attempt can be made to answer the question posed above by relating the growth of specific industries to the levels of effective protection enjoyed by them.

In Table 8 the changing levels of effective protection provided to major export industries between 1992/93 and 1997/98 have been presented. This can be compared with the growth rates of these industries shown in Table 6. Table 8 shows that ERP for jute textiles has been halved through import liberalization and lowered to 48% in 1997/98, yet this industry has experienced negative growth. ERP for leather and leather products has been brought down by 91%, but the average growth rate of this industry has been only 1.4%; it may be noted that ERP for this industry in 1997/98 was only 8.8%. On the other hand, effective protection rate for the garments industry has been reduced by 72% and was about 65% in 1997/98 (i.e. higher than for jute textiles and leather), and the associated average annual growth rate was 20%. This clearly shows a weak relationship, if one exists at all, between the level of effective protection and the rate of industrial growth. Evidently, other more important factors have been in operationin determining the growth rate.

An attempt will now be made to relate the growth of major import-substituting industries to changing levels of ERP between 1992/93 and 1997/98, the latter being displayed in Table 9. The negative growth of cotton cloth, sugar and paper industries has already been noted above. Table 9 shows that although effective protection provided to mill cloth has been reduced by 54%, ERP stood at

86% in 1997/98, which is on the high side. However, this level of protection may not have been adequate for some of the enterprises whose level of efficiency was lower than that required to compete successfully with imports. As a result, there was a contraction in the production of cloth, implying a decline in the utilization of existing capacity. On the other hand, ERP in the case of the paper industry has been brought down by 81% and stood at about 13% in 1997/98. Despite this sharp reduction in and the resulting low level of effective protection, or because of it, local paper production experienced regression. In the case of the sugar (including 'gur') industry, ERP was reduced to 40% (with a reduction of 58% in the level of effective protection), but this industry also experienced negative growth. In other words, the level of protection was inadequate for a somewhat inefficient industry to withstand the pressure of import competition. By contrast, ERP for the pharmaceutical industry was less than 1% in 1997/98, having declined by 53%, and yet this industry posted the impressive average annual growth rate of 13.6%. This clearly indicates that this industry is efficient and has therefore been able to compete successfully with imports.

The sum and substance of the foregoing analysis is that while trade liberalization may be a necessary condition for efficient industrial growth, it is not a sufficient condition. Efficiency in production depends not only on the level of import competition but also, and perhaps more heavily, on the state of business support services, adequate supply of infrastructure, sufficient supply of skilled labour, easy access to credit on reasonable terms, and above all, good governance which would ensure eradication of corruption, theft and "toll" collection. These factors have in fact also been cited by respondents as constraints to doing business in Bangladesh in an enterprise level survey carried out by World Bank (World Bank, 1999a). If these other factors determining efficiency are absent or inadequate, then manufacturing enterprises fail to enhance efficiency and competitiveness, and the result would be their elimination or decline in the face of import competition unleashed by trade liberalization. The lesson here would seem to be to make the speed of liberalization consistent with the pace of development of these other cooperant factors.

The other thing to keep in mind while designing trade liberalization is that employment considerations may need to be given greater weight than efficiency considerations in a poverty-stricken country like Bangladesh, at least in the short and medium term. If industries are slow in restructuring, they should be given some more time to increase production efficiency so that import competition can

be faced successfully. The alternative to this is enterprise closures and lay-off. In a country where unemployment and underemployment are already high, the prevalence of efficiency over employment considerations in industrial planning may not be prudent, let alone equitable. Adopting the naive text-book approach that resources would be automatically reallocated to more efficient sectors from the inefficient, dying ones in response to changing relative prices may be injudicious. Apparently such reallocation of resources has not occurred in any significant manner in Bangladesh as yet; various factors like market fragmentation, structural rigidities, and inadequacies in the arena of cooperant factors which contribute towards enhancing efficiency and competitiveness have been responsible for this. If employment and equity considerations are to be given more weight, then the pace of import liberalization may need to be slowed down.

An attempt will now be made to explain the lack-luster growth performance of small and cottage industries, a large segment of which belongs in the informal sector. Rural industries and urban informal industries are included in the informal sector. Informal sector industries generally use locally produced inputs. Hence, the beneficial effect of import liberalization on production in the informal sector industries through reducing input prices is likely to have been small. On the other hand, the adverse effect of liberalization on production through the demand channel is likely to have been stronger. This may have manifested itself in two ways. The informal sector is run by the poor for the poor. Hence, stagnating wage incomes in agriculture and a decline of wage incomes in contracting formal sector industries are likely to have adversely affected demand and hence output of informal sector products. Table 10 shows clearly that the real wage rate in agriculture has stagnated between 1992/93 and 1997/98. Furthermore, given their weak competitive position, informal sector industries which produce tradables are likely to have been adversely affected by import liberalization. Evidence furnished in the next section shows a sharp fall in employment in the informal manufacturing sector during the 1990s. This is supportive of the above argument.

The demand for the products of informal sector industries, particularly rural industries, depends to a large extent on the growth of agricultural incomes. From Table 10 it is found that the average growth rate of agriculture between 1990/91 and 1997/98 was 2.2%. A sudden spurt in agricultural growth is observed in 1996/97. If this year is excluded, then the average growth rate of agriculture falls to 1.6%. The average annual growth rate of the crop sector, whose average share in total agricultural

production in the nineties was 76%, for the above period was 1.1%; if 1996/97 is excluded since it exhibits a growth rate much higher than the trend growth rate, the average annual growth rate for the crop sector comes down to 0.34%. The implication of all this is that the growth of demand for the output of informal sector manufacturing industries during the nineties must have been weak. The close correlation between the rate of agricultural growth and the growth of real wages in agriculture is also observed from Table 10.

There factors, among others, have been responsible for weak agricultural growth, and these were related to the process of liberalization which has taken place under SAP (Shahabuddin, 1999). Firstly, substantial imports of foodgrains have been made by the private sector which have depressed foodgrain prices and hence acted as a disincentive for increasing domestic production. Secondly, subsidies provided to agricultural inputs were either eliminated or greatly reduced, and costs of production increased as a result. Rising cost of production together with depressed output prices had a dampening effect on agricultural production. Thirdly, agricultural credit was previously available at concessional rates of interest. Subsequently, however, interest rates on agricultural loans were raised with the objective of restoring discipline in the financial sector. The net outcome of these three forces operating in concert was that while costs of agricultural production were rising, on the one hand, profitability was declining due to falling output prices, on the other. This had discouraged farmers from increasing output levels more rapidly.

The slow pace of financial sector reforms, together with flaws in their design, have, in the face of a faster speed of import liberalization, constrained growth of productive sectors - both formal and informal. As can be seen from Annexure Table 1, financial sector reforms have been undertaken since the late 1980s with the general objective of putting in place a sound and healthy financial system which would ensure efficient allocation of financial resources to the productive sectors. Liberalization of the interest rate regime was an important element in this strategy. However, the oligopolistic nature of the financial market wherein a few, inefficient nationalized commercial banks (NCBs) dominated led to collusive price behavior among banks, and this contributed towards the establishment of high real interest rates which was a sharp contrast to the objective of liberalization, viz. establishing lower real rates of interest. The situation was exacerbated by inadequate supervision and prudential regulations in

the banking sector as well as the general weakness of financial institutions. Furthermore, financial reforms had reduced the role of directed credit which, although desirable from the point of view of removing market distortions, had the undesired effect of reducing credit flow to priority productive sectors by making lending by banks characterized by weak managerial capacity a riskier proposition than before. The result of this was that neither NCBs nor the private banks showed any great interest in extending credit to the productive sectors, particularly agriculture and small and cottage industry, because of high perceived risks and costs, and this resulted in a serious misallocation of financial resources. Even the World Bank has admitted that, "interest rate reform did not contribute to an improvement in resource allocation, but simply to increased cost of resources." (World Bank, 1997)

Bangladesh Bank statistics, as quoted in Chowdhury and Raihan (2000), show that there has occurred a sharp reduction in advances made by scheduled banks to the agricultural sector from 24.94% in 1987 to 12.23% in 1998. The share of small and cottage industry, which was already low, declined further from 3.32% to only 1.53% during the same period. The share of large and medium scale industry increased slightly from 24.30% to 27.99%, but this is the sector plagued by loan default. Interestingly, the share of non-tradable sectors like construction has increased from 3.22% to 5.36% during the above period.

The study by Chowdhury and Raihan op.cit. also shows a reduction in the loan-output ratio, which may be considered as a good indicator of efficient credit allocation, in the agricultural sector and the small and cottage industry sector between 1987 and 1998. This was the result of pursuing the policy of interest rate deregulation and weakening of credit programmes directed towards priority sectors. In the case of agriculture, the loan-output ratio declined from 0.677 to 0.428. Although the ratio increased for industry as a whole, it fell sharply from 0.859 to 0.398 for small-scale industry.

It may also be noted that the real interest rate on advances made by scheduled banks has been significantly above 9% since the mid-nineties. The weighted average nominal interest rate on advances by scheduled banks has been 14% in 1998 and 1999, which is high.

An important element of the present SAPRI exercise is that it incorporates the results of participatory research. The results of using participatory research techniques are contained in a separate report (Rahman et. al., 2000) prepared under the SAPRI umbrella project. Participatory Rapid Appraisal (PRA), Focus Group Discussion (FGD) and Individual Interview, along with other

participatory techniques, were used to generate data, mostly qualitative in nature. The author of the present study was associated in the above study (as dictated by his TOR) through contributing in designing questions for the import liberalization - related portion as well as by participating in FGDs and some individual interviews. Although the research findings are contained in detail in Rahman op.cit., it is very relevant to summarize the findings of participatory research related to import liberalization in the present paper. This is done below.

FGDs and individual interviews have revealed the almost unanimous perception of stakeholders, except for relevant government officials interviewed, that the policy of import liberalization has been implemented too fast and the extent of liberalization has been too much. Enough time was not given to the producers to prepare for facing the competition from imports. Since the industrial base was not yet strong enough to withstand import competition, it wilted in the face of foreign goods "that flooded the domestic market."

Interpreting stakeholders' perceptions in analytical terms it is found that the pace and sequence of import liberalization has been identified as having been faulty. Stakeholders emphasized the weakness that characterized business support services and business environment in Bangladesh - inadequate business support services and frequent changes in related policies, political instability, and terrorism and toll collection. These factors contribute towards increasing the cost of doing business. The slow pace of other complementary policy reforms has impeded the process of preparing the manufacturing sector in particular to face import competition; such preparation would include putting in place a favourable social condition, a sound work culture and a skilled labour force, a framework for rapid technological development, easy access to capital at reasonable cost, etc. The result has been that domestic manufacturing industries, particularly small and cottage industries, have been adversely affected by import liberalization.

A survey of stakeholders carried out for the study by Chowdhury and Raihan op.cit. indicates the low availability of credit for small enterprises. Nearly 53% of stakeholders in the rural sector were found to have no access to credit (formal or informal) at all. The survey also shows that half of stakeholders in the small and cottage industry sector have no access to formal credit.

VI. IMPACT OF TRADE POLICY REFORM ON INDUSTRIAL EMPLOYMENT

A major objective of economic development is to improve the economic and social well-being of the population. A stated economic objective of the Government of Bangladesh has therefore been to achieve growth with equity, implying a reduction in poverty and attainment of a more equitable distribution of income. Poverty alleviation and greater equity in the distribution of the benefits of growth call for, among other things, a rapid increase in employment. The objective in this section is therefore to examine how trade liberalization has impacted on employment in the industrial sector and thereby affected attainment of the declared goal of the Government to have economic growth with social justice.

Data on the civilian labour force and employment are available from 1974 till 1995-96 from Census and Labour Force Surveys. Relevant data from these sources are presented in Table 11. The table shows that while employment has increased from 50.1 million in 1989 to 54.6 million in 1995-96, the number of unemployed persons has also increased from 0.6 million to 1.4 million during this period. This increase in employment and unemployment at the same time indicates that the labour force has grown at a faster rate than the creation of job opportunities. The data show that open unemployment had declined consistently from 8.68% to 1.18% between 1974 and 1989. However, the unemployment rate increased to 1.96% in 1990-91 and 2.50% in 1995-96. Unemployment of women has increased at a faster rate than that of men.

The observed increase in open unemployment has occurred during the period when the process of import liberalization was accelerated. In theory, unemployment will increase when (i) workers who are already employed get laid off, and (ii) when productive sectors of the economy are growing at a rate which is lower than that required for absorbing new entrants into the labour force as well as for providing employment to retrenched workers. Viewed from this perspective, the impact on employment of economic reforms including trade liberalization can be more easily understood. Firstly, industrial restructuring to cope with import competition together with privatization of state- owned enterprises have led to labour shedding in some large and medium enterprises in the manufacturing sector. The fact that female workers are more vulnerable to enterprise restructuring because they are largely unorganized partly explains the faster rate of unemployment observed among women workers.

Secondly, it has already been noted above that import liberalization has adversely affected the output growth of several large and medium - scale industries which compete with imports. Furthermore,

throughout the 1990s employment elasticities of manufacturing output have been falling at both the aggregate and sub-sector levels. Among other things, this can be attributed to capital-deepening by large and medium sized manufacturing enterprises in their effort face import competition through increasing productive efficiency. Under these conditions, one would expect the rate of labour absorption in the large and medium-scale manufacturing sector to decline. However, this has not happened because the very impressive output growth achieved by a few selected industries, notably garments and pharmaceuticals, has more than offset the decline in output growth of major import-substituting industries. As a result, employment in the large and medium-scale manufacturing sector as a whole has increased (empirical evidence in support of this is presented below). However, the sustainability of such employment creation is crucially dependent on how Bangladesh's garments industry copes with the challenges of an MFA quota-free trading environment that will be in place from 1 January 2005.

The sectoral distribution of employment in Bangladesh is shown in Table 12. The table shows that the absolute level of employment has fallen sharply in the industrial sector between 1989 and 1995-96. For industry as a whole, employment has declined from 7.8 million to 5.2 million, i.e. a fall of 33%. The contraction in employment has been sharper for manufacturing industry where employment has shrunk from 7 million in 1989 to 4.1 million in 1995-96. As a result, the share of manufacturing industry in total employment has come down from 14% to 7.5% during the above period. It was noted above that employment in large and medium-scale industry should have increased in the face of a healthy growth of output, albeit concentrated in a few industries. Hence, the sharp reduction in employment in the manufacturing sector as a whole, which is observed from Table 12, has evidently occurred in the small and cottage industry sector. A large part of this unemployment is likely to have taken place in informal sector industries in both urban and rural areas.

Data shown in Table 14 support the analysis presented above. The predominance of the non-formal sector in employment generation in Bangladesh is brought out clearly by data presented in this table. Although the importance of the informal sector in creating employment has declined slightly since the mid-eighties, this sector is estimated to have accounted for about 88% of total employment in the country in 1995-96. In sharp contrast to this, the share of the informal sector in total manufacturing employment has fallen dramatically from nearly 82% in 1983-84 to only 4.6% in 1995-96. This drastic fall in the employment share of the informal manufacturing sector has been the result of a negative annual

growth of 18% in employment in this sector. On the other hand, there has occurred a significant growth in employment in the formal manufacturing sector (which is defined as employment in establishments employing 10 and more workers and hence represents employment in large and medium-scale industry). Given the preponderance of the informal sector in total manufacturing employment, the dramatic reduction in employment in the informal manufacturing sector caused the sharp contraction in total manufacturing employment noted in Table 12.

The BIDS (1997) study also shows that three informal sectors have increased their employment share in 1995-96; these three sectors are: (i) trade, hotel and restaurants, (ii) transport, storage and communication, and (iii) community and personal service. The average annual growth rate of employment creation in these sector have been: 5.2% for trade, hotel and restaurants; 6.8% for transport, storage and communication; and 6.7% for community and personal service. The average annual growth rate of total non-formal employment between 1983/84 and 1995/96 has been 2.4%. Thus, many of the workers who lost their jobs in the informal manufacturing sector may have been absorbed in the three service sectors mentioned above.

Data presented in Table 13 seem to support the findings noted above. From the table it is seen that the share of full - time wage employment in total employment has risen from 9.5% in 1989 to 12.4% in 1995-96. This is consistent with the increase in employment in large industry noted above. It is also noted from Table 13 that the share in total employment of unpaid family workers has declined from 45.8% to 40.1% between 1989 and 1995-96, while the proportion of day labourers in the total number of employed persons has risen from 15.1% to 17.9%. Unpaid family workers are almost overwhelmingly used in agriculture and informal industry (rural as well as urban). The decline in the employment share of unpaid family workers is consistent with the observed reduction in employment in non-formal manufacturing noted above. Many of the workers released from urban informal industry is likely to have taken up work as day laboures in the urban construction industry which has flourished in the 1990s.

Is there any causal relationship between trade liberalization and the observed dramatic contraction in non-formal manufacturing employment and thence a sharp reduction in employment in the manufacturing sector as a whole ? To answer this question one can begin by noting that trade liberalization can affect output and employment growth in the informal sector from both the supply and

demand sides. On the supply side, trade liberalization may reduce costs of production and thereby improve the competitiveness of informal sector manufactures vis-a-vis similar products produced by domestic formal sector industries and imported goods. The magnitude of this competitiveness - enhancing effect of liberalization would evidently depend on the extent to which imported inputs are used in production in the informal sector. On the demand side, liberalization can directly affect informal sector manufacturing industries producing tradables by exposing them to import competition; it can also exert an indirect effect by influencing the growth of sectors which are the source of demand for goods produced by informal sector industries.

An ILO study (ILO,1998) shows that the cost of raw materials dominates the production cost of manufacturing enterprises in the informal sector in Bangladesh, while capital constitutes only a small proportion of the cost of production. Generally, locally produced raw materials are used by informal sector manufacturing enterprises. Hence, the beneficial effects of import liberalization are likely to be very limited on the supply side. On the demand side, many of the goods produced by informal industry face competition from imports as well as goods produced by manufacturing enterprises in the formal sector. Import liberalization may therefore have exerted some negative influence on the production of goods by informal industry, particularly in view of their low quality. Sluggish growth in demand would be a more important factor which has constrained output and employment growth in the informal manufacturing sector. As noted earlier in the previous section, import liberalization (together with withdrawal or reduction of agricultural input subsidies) is likely to have contributed to slackening demand for informal sector manufactures by reducing agricultural growth rate.

A more detailed study of the informal manufacturing sector from the perspective of trade liberalization is required to provide more concrete and conclusive evidence relating to the impact of liberalization on employment in this sector. Nonetheless, the foregoing analysis seems to indicate that the net effect of liberalization on employment in the informal manufacturing sector (and hence on total manufacturing employment) is likely to have been negative.

The results of participatory research (Rahman et.al., op.cit) show that small and cottage industries have been worst affected by import liberalization in terms of output and employment bss. Many small enterprises including small engineering workshops, rural industries, bakery and biscuit factories have been forced to close down due to easy inflow of foreign goods. Self-employment has

also been adversely affected due to the pressure of import competition on small and cottage industries. The participants in FGDs emphasized that many small industries (e.g., khadi of Comilla) are being wiped out from the market by cheaper and better-quality imports.

VII. EXCHANGE RATE DEPRECIATION AND COMPETITIVENESS

Trade liberalization is expected to promote export growth by reducing policy-induced anti-export bias. An overvalued exchange rate (ER) would discourage exports and thereby could frustrate the achievement of the goal of trade liberalization. In other words, an 'appropriate' ER policy will complement trade liberalization by enhancing export competitiveness and at the same time help to contain import growth in the face of ongoing import liberalization. Hence, the Bank-Fund have included liberalization of the exchange policy regime in the SAP package, as can be seen from Annexure Table 2. Particular attention has been paid by the donors to removal of overvaluation of the Taka through regular nominal devaluations. The objective in this section is to examine the desirability and effectiveness of using the policy of ER depreciation to augment external competitiveness and thereby attain higher levels of export growth.

The Real Effective Exchange Rate (REER) index (1990=100) constructed by the IMF and quoted in World Bank (199a) shows that between 1990 and 1996 there occurred a 5.6% real devaluation of the Taka; however, by 1998 the REER had appreciated by about 4%. Before moving on to an analysis of the effectiveness and desirability of currency depreciation in Bangladesh, a comment on the methodology of measuring the REER seems to be in order. Firstly, it may be noted that difficulties surrounding the measurement of the degree of misalignment of the currency are well-known; these difficulties may stem from the need to choose appropriate price indexes, the choice of base year, etc. Hossain et.al. (1997) constructed six alternative measures of the real exchange rate (RER) and the conclusion was reached that there was little sign of currency misalignment upto 1994. Of course it is quite possible, as the IMF REER index shows, that there has been some misalignment of the Taka in the late 1990s. However, the point being made is that alternative indexes may be constructed to double-check on the degree of misalignment.

The ER is a key price in the economy which affects resource allocation and hence the aim should be to achieve and maintain an 'appropriate' ER at which exports are competitive, sustained foreign exchange inflows are adequate to meet external payment obligations, sufficient reserves are available for meeting unforeseen needs, and domestic prices are stable. Judged by these criteria, the ER was overvalued during the 1970s and for most part of the 1980s. However, reform measures undertaken in the foreign exchange market have helped to gradually bring the ER to an 'appropriate' level. A multiple ER regime was in operation in the 1970s and the 1980s. A Secondary Exchange Market (SEM) was created in 1985 with a Secondary Market Exchange Rate. The SEM rate was about 12% depreciated compared to the official rate in 1985 (Kazmi, 1998). The official ER was depreciated in phases to narrow down the gap with the SEM rate, with unification completed by 1 January 1992. Active adjustments of the ER towards elimination of overvaluation of Taka and abatement of inflation improved macroeconomic stability and permitted the gradual phasing out of restrictions on current external settlements. Full current account convertibility of Taka as per IMF Article VIII definition was attained by early 1994. Capital account settlements were also liberalized to some extent to attract non-resident investment flows into the economy.

Since we are considering the appropriateness of the ER, it would be pertinent to explain briefly how the ER is monitored by the authorities. To monitor changes in trade competitiveness, the Purchasing Power Parity based index of REER was brought into use from 1985. This index is a combination of the nominal ERs and inflation rates of the currencies in the trade-weighted basket of currencies to which Taka is pegged. Movements of the REER index reflect changes in competitiveness of traded goods of Bangladesh relative to those of her trade partners. Apart from looking at the REER movements, the Bangladesh authorities also consider other macroeconomic factors like international reserves, current account gap, domestic inflation, external debts etc. while assessing the appropriateness of the ER. Furthermore, it may be noted that in the early 1990s an interbank foreign exchange market was activated with the aim of equilibrating available supplies of foreign exchange with the prevailing demand at a market clearing ER.

After reunification of the official and SEM ERs in January 1992, to ER continued to be adjusted on the basis of movements of REER and other indicators mentioned above. In the context of a unified formal exchange market one would look at the illegal kerb market ER trends for indication whether the

official ER is falling out of line. Till 1998 the ER premia in the illegal kerb market has generally remained around 2%. This small difference is representative more of the risk of illegal transactions than any significant misalignment of the official ER. The kerb rate increased somewhat during the last quarter of 2000. However, this can be attributed to an increase in illegal trade rather than any serious misalignment of the currency.

Whether export growth is likely to be significantly stimulated by devaluation depends on the price elasticity of supply at home and the price elasticity of demand abroad for the export commodities. Bayes et.al. (1995) estimated an export supply function linking export value with relative price and capacity output of the tradable sector as determinant variables. Their estimate found statistically insignificant sensitivity of export supply to price but significant strong sensitivity to capacity output. To estimate price elasticity of export demand facing Bangladesh the author used a demand function linking export demand with export prices and index of real income of the trade partners as determinants. Their estimate revealed high sensitivity of demand of Bangladesh's exports to income growth of trade partners; the price elasticity of export demand was however found to be low, a 10% decrease in export prices was seen as likely to raise demand abroad for Bangladesh's exports by about 5%. Studies by other investigators (e.g., Shilpi, 1990; Ahmed et.al., 1993) report similar general findings about the supply-side constraints and relatively low price elasticity of demand for Bangladesh's exports. Another recent study (panagarriya, et.al., 1996) however found consistently high values of price elasticity of demand for Bangladesh's exports.

Overall, available evidences indicate that devaluation can increase exports of Bangladesh to some extent provided supply-side constraints are addressed. Devaluation should not however be relied upon to ensure competitiveness. This compensatory measure against inefficiencies elsewhere in the economy only delays removal of the inherent problem.

The other dimension of the issue is that devaluation causes inflation and output contraction, a phenomena which is observed from the experiences of a large number of developing countries. Devaluation increases costs of intermediate inputs. With high import intensities in production, this could lead to cost- push inflation. The consequent decline in real wages and hence aggregate demand could result in economic recession.

The objective of maintaining a competitive price by lowering the REER for exportables through devaluation could be frustrated if export activities depend significantly on imported inputs, which is generally the case in Bangladesh.. The competitive price outcome would be eroded as higher import costs would force exportable prices to rise. In some cases, direct subsidies may be the more efficient policy rather than devaluation to protect the gains of exporters in the face of adverse international relative price movements.

Mahmud (1998) has suggested another explanation of how currency devaluation may lead to inflation in Bangladesh. Bangladesh's dependence on external aid and remittances may have given rise to a variant of the 'Dutch discuss', whereby demand from dollar denominated inflows causes returns in the non-traded service sector to rise relative to the traded commodity producing sectors. This would draw resources away from the tradables sector to the non-tradables sector. Combined with low growth in domestic investment, this structural feature means that nominal devaluation may further reduce the relative returns in agriculture and industry compared to services and cause further inflation, rather than lead to any real depreciation.

It may be argued that when devaluation is combined with austerity achieved through demand management, this policy mix would alter relative prices in favour of tradables and thereby accelerate the process of resource transfer to the tradables sector. However, the output contraction that is almost certain to come about would not allow the process to work itself out. Devaluation may improve the trade balance but at the cost of inflation and recession.

Empirical studies give mixed results regarding the link between devaluation and inflation. A study by Jamsheduzzaman (1998) has reported two-way Granger causality between inflation and devaluation. Estimating a regression model linking inflation with money supply and devaluation, the study reported a 0.564% rise in inflation for 1% devaluation over a period of two months. On the other hand, Hossain and Kapoor (1998) used data for about the same period (July 1995 to April 1998) and reported that the null hypothesis of devaluation not causing inflation could not be rejected. Using a somewhat differently specified regression model linking inflation with devaluation and money supply, the authors found a stronger correlation of money supply with inflation but no statistically significant correlation at all between devaluation and inflation. The conflicting results of the two studies regarding the devaluation - inflation linkage may have stemmed from multi- collinearity which resulted from using two inter - related

variables, money supply and devaluation, as determinants of inflation, with consequent failure of both model specifications to precisely pick up the separate effects of each.

It is instructive to note that the share of tradables output in GDP has actually declined in Bangladesh during the 1990s. Thus, during 1990/91 - 1997/98 the combined share of agriculture and industry in GDP has declined from 50.7% to 48.8%. This seems to indicate the failure of both trade liberalization and currency devaluation to shift resources out of the non-tradables to the tradables sector.

It is important to note that even if ER depreciation is successful in maintaining price advantage in world markets, it can only be a temporary solution. Overvaluation of the ER basically suggests high domestic production cost of exportables. The disease cannot be cured by continuously depreciating the domestic currency; the resulting inflation will eventually frustrate the aim of the devaluation itself. A more fundamental and lasting cure would be to increase factor productivity and lower costs of production in the long run. Policies should be put in place with this objective in view.

VIII. CONCLUDING REMARKS

While it is generally believed that reforms aimed at economic liberalization have been undertaken since the mid-eighties in Bangladesh, an examination of the relevant documents reveals that the policy of trade liberalization, in particular the policy of import liberalization, has been implemented since 1982. The pace of import liberalization was however accelerated in the 1990s and significant liberalization and rationalization of the import regime in terms of reducing the maximum tariff and the number of tariff slabs, sharply reducing the coverage of quantitative restrictions, easing import procedures, etc. was achieved during this period. At the same time, a number of export incentive schemes whose main objective was to provide export-oriented producers with access to world-priced inputs was also put in place.

In the pre-reform period, i.e. during the seventies and early eighties, the economic situation in Bangladesh was far from satisfactory. Among other things, GDP was growing sluggishly, inflation rates were high, the current account deficit was widening and foreign exchange reserves were at a precariously low level. Such unhealthy economic conditions did indeed warrant the introduction of economic reforms. However, a contention of this study is that the implementation of trade policy

reforms which involved import liberalization may have been somewhat premature. The fiscal deficit and inflation rate should have been reduced to manageable proportions before introducing trade policy reforms.

Ownership of reforms is critical for their successful implementation. In turn, ownership is expected to be closely linked with national participation in designing reforms. Even though no unambiguous answer can be given to the question of whether the reforms which were implemented were fully owned by the Government of Bangladesh, indirect evidences nonetheless indicate that by and large reforms were designed by the World Bank and IMF and that these reforms may not have been fully consistent with the development aspirations of the country as reflected in the five-year plan documents. In its own evaluation of the reform process the World Bank has admitted that inadequate ownership of reforms by the Government has hindered their successful implementation. Regarding national involvement in the design of trade policy reform it can be said that such involvement has been marginal, simply because the Government appears to lack the required technical capacity. A technically strong and autonomous Tariff Commission which should place its reports directly to the national Parliament for its consideration may be an answer to this problem. Whatever the mechanism used, the urgent need for the Government to carefully monitor the impact of import liberalization can hardly be overemphasized. The reform process may be redesigned, if necessary, in the light of the findings of the monitoring exercise.

At the aggregate level, trade policy reform is found to have been associated with an increase in the growth rate of manufacturing output in the 1990s compared to the 1980s. Increased levels of imports of capital goods and intermediate inputs in the 1990s also seem to indicate an increase in industrial capacity as well as higher rates of utilization of existing capacity in the wake of import liberalization. A closer look however brings to light two interesting dimensions of industrial growth that has occurred side by side with import liberalization. Firstly, large and medium-scale industries appear to have benefitted from import liberalization while small and cottage industries have been adversely affected. Secondly, within the large and medium-scale manufacturing sector, only a handful of export-oriented industries, notably ready-made garments, and a few import-substituting industries like pharmaceuticals have posted healthy growth rates during the era of import liberalization. On the other

hand, a large segment of the import-substituting industrial sector appear to have been adversely affected by liberalization.

It cannot be established beyond any shadow of doubt that there exists a causal relationship between the policy of import liberalization and the growth of the major manufacturing industry in Bangladesh, viz. ready-made garments. While access to imported inputs at zero duty may have facilitated growth of this export-oriented industry, international garments market conditions, viz. the MFA-quota system, has undoubtedly been the major factor in spurring growth of this industry. On the other hand, the unpreparedness and inability of many import-competing industries to face the rigours of import competition have led to economic regression in this sector. Several factors may be held responsible for the inability of domestic firms to withstand import competition: (i) high cost of credit, (ii) high price and irregular supply of utilities, (iii) weak physical infrastructure, (iv) low level of technological development, (v) low labour skills, (vi) high cost of doing business, etc. The slow speed of complementary reforms has largely contributed to this state of affairs. The policy implication of this is clear: the speed of import liberalization should be reviewed and made consistent with the pace of complementary reforms in other sectors.

The impact of import liberalization on industrial employment has been similar to its effect on industrial capacity, which is as expected. There has occurred a sharp contraction in industrial employment during the phase of accelerated liberalization; employment in the manufacturing sector has fallen dramatically during this period. While employment in the large and medium-scale manufacturing sector may have increased, employment in the non-formal industrial sector has shrunk drastically. Even though it is difficult to establish any causal link between declining employment levels in informal industry and import liberalization, a qualitative analysis of existing data seems to indicate that import liberalization has exerted some negative effect on employment in the non-formal sector. There is definitely a need for more study in this area.

Finally, it has been argued that currency depreciation should complement trade policy reforms to increase the competitiveness of Bangladesh's exports. This study concludes that using the policy of currency depreciation to enhance Bangladesh's export competitiveness may be self-defeating due to the inflationary pressure it is likely to generate. Furthermore, many studies seem to indicate that devaluation may in any case have only a marginal salutary effect on Bangladesh's exports given the price-inelastic

nature of the export demand and supply functions. It is suggested that rather than using devaluation to stimulate export growth, policies should be put in place to increase factor productivity in the country. Such policies may include skill-training of labour and the introduction of new and more efficient technology. There is a need for further study in this area.

Table 1

Growth Performance of the Manufacturing Sector (at constant 1984-85 prices)

(Percentage)

	1992/ 93	1993/ 94	1994/ 95	1995/ 96	1996/ 97	1997/ 98	1998/ 99
Growth Rate:							
Large & Medium	13.2	10.2	11.2	6.0	3.3	11.0	2.2
Small & Cottage	2.9	4.0	4.2	3.9	3.9	6.8	3.0
Total	9.1	7.8	8.6	5.3	3.5	9.5	2.5
Share of GDP:							
Large & Medium	6.5	6.9	7.4	7.4	7.2	7.6	7.4
Small & Cottage	4.0	4.0	3.9	3.9	3.9	3.9	3.8
Total	10.5	10.9	11.3	11.3	11.1	11.5	11.2

Source: Bangladesh Bureau of Statistics

Table 2

Manufacturing Growth: CPD Estimate

	1990/91	1991/92	1992/93	1993/94
Rate of Growth of Large Mfg.%)	2.4	6.0	7.6	7.6
Adjusted Growth Rate of Large Mfg. Excluding RMG	1.7	4.1	5.0	4.8

Source: Zaid Bakht (1998).

Table 3

Growth Rates of Imports of Capital Goods and Intermediate Inputs

(Percentage)

	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
Excluding non-SBW bond, baggage and diplomatic									
Intermediate Inputs	4.8 (35.7)	-2.3 (30.5)	3.8 (33.9)	-0.4 (31.4)	6.2 (31.1)	28.8 (27.6)	19.3 (28.7)	3.3 (29.0)	5.0 (27.4)
Capital Goods	55.9 (18.7)	-10.6 (14.6)	20.2 (18.8)	-11.2 (15.5)	-2.0 (14.2)	48.9 (14.6)	39.0 (17.6)	0.2 (17.2)	3.3 (16.1)
a. Capital machinery & parts	51.5 (13.2)	-0.8 (11.5)	22.8 (15.1)	-18.1 (11.5)	-6.8 (10.0)	42.4 (9.8)	44.2 (12.3)	-9.4 (10.9)	15.2 (11.3)
b. Other	67.4	-34.4	10.7	17.0	11.7	64.6	28.3	22.4	-16.9

Capital goods	(5.4)	(3.1)	(3.7)	(4.0)	(4.2)	(4.8)	(5.3)	(6.4)	(4.8)
Enclave									
a. B/B L/C SBW Fabric	n.a.	29.5 (16.9)	20.7 (21.8)	16.4 (23.7)	17.9 (26.0)	50.6 (27.0)	-7.7 (21.7)	10.1 (23.3)	19.5 (25.1)
b. Export Processing Zone	113.3 (1.0)	25.0 (1.1)	26.1 (1.5)	68.9 (2.3)	42.0 (3.0)	63.0 (3.4)	32.6 (4.0)	53.6 (5.9)	22.8 (6.6)

Source: World Bank (1999)

Note : Figures in parentheses indicate percentage shares of total imports

Table 4
Imports of Capital Goods and Intermediate Inputs as Share of GDP

(Percentage)

	1989/ 90	1990/ 91	1991/ 92	1992/ 93	199 3/94	1994/ 95	1995/ 96	1996/ 97	1997/98
Excluding EPZ									
Capital Goods	1.99	1.75	2.08	1.80	1.68	2.23	2.89	2.83	2.83
Intermediate Inputs	5.40	5.68	6.16	6.38	6.76	8.37	8.27	8.57	9.26
Capital Goods & Intermediate Inputs	7.39	7.43	8.24	8.18	8.44	10.60	11.16	11.40	12.09
Including EPZ									
Capital Goods & Intermediate Inputs	7.50	7.57	8.40	8.45	8.80	11.12	11.81	12.37	13.25
Excluding SBW Fabric & EPZ									
Capital Goods	1.99	1.75	2.08	1.80	1.68	2.23	2.89	2.83	2.83

Intermediate Inputs	3.81	3.66	3.75	3.64	3.68	4.23	4.71	4.74	4.83
Capital Goods & Intermediate Inputs	5.80	5.41	5.83	5.44	5.36	6.46	7.60	7.57	7.66

Source: Calculated from data available in World Bank (1999a).

Table 5
Trend of Manufactured Exports

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
GDP (US $ Million)	30746	31163	31934	33559	37614	40343	41345	42647
Manufactured Exports (US$ Million)	1586.0	1874.0	2267.0	2427.6	3050.2	3748.1	4245.0	4994.5
Total Exports (US$ Million)	1717.6	1993.5	2382.9	2533.9	3472.6	3882.8	4418.3	5161.2
Exports of RMG & Knitwear (US$ Million)	866.8	1182.6	1445.0	1555.7	2228.4	2547.1	3001.2	3783.6
Mfd. Export/GDP (%)	5.2	6.0	7.1	7.2	8.1	9.3	10.3	11.7
Mfd. Export/Total Export (%)	92.3	94.0	95.1	95.8	87.8	96.5	96.1	96.8
RMG & Knitwear Export/Mfd. Export	54.6	63.1	63.7	64.1	73.1	68.0	70.7	75.8
RMG & Knitwear Export/Total Export	50.5	59.3	60.6	61.4	64.2	65.6	67.9	73.3

Source: Calculated from data provided in Table B.2 in Annex II of World Bank (1999a)

Table 6

Quantum Index of Production of Major Export Industries
(Base: 1988-89 =100)

BSIC Code No.	Industry	Weight	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
3213	Jute Textile	14.07	81.69	87.52 (7.1)	82.75 (-5.4)	83.46 (0.9)	79.46 (-4.8)	80.13 (0.8)	80.59 (0.6)
3231	Garments	9.13	230.55	268.94 (16.6)	273.56 (1.7)	354.95 (29.7)	439.98 (24.0)	507.10 (15.3)	644.89 (27.2)
3126/27	Tea	7.87	109.41	118.47 (8.3)	123.53 (4.3)	112.93 (-8.6)	123.65 (9.5)	127.82 (3.4)	128.60 (0.6)

3241	Tanning & Finishing Leather	2.49	92.97	108.72 (16.9)	123.44 (13.5)	126.77 (2.7)	174.46 (37.6)	100.84 (42.2)	102.25 (1.4)
3114	Fish & Sea food	1.81	108.95	125.20 (14.9)	143.64 (14.7)	171.07 (19.1)	169.44 (-0.9)	167.60 (-1.1)	121.25 (-27.7)

Source: Bangladesh Bureau of Statistics

Note: Figures in parentheses are annual growth rates

Table 7

Quantum Index of Production of Major Import Substituting Industries (Base: 1988-89 =100)

BSIC Code No.	Industry	Weight	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
3524	Fertilizer	11.34	108.57	128.28 (18.1)	148.02 (15.4)	134.22 (-9.3)	140.63 (4.8)	110.89 (-21.1)	127.03 (14.5)
3211	Cotton Textile	7.83	116.49	112.11 (-3.8)	103.15 (-8.0)	84.47 (-18.1)	85.16 (0.8)	84.13 (-1.2)	88.27 (4.9)
	I. Yarn	6.17	123.34	123.51 (0.1)	117.78 (-4.6)	100.14 (-15.0)	103.79 (3.6)	102.22 (-1.5)	107.76 (5.4)
	II. Cloth	1.66	91.01	69.74 (-23.4)	48.78 (-30.0)	26.26 (-46.2)	15.80 (-39.8)	16.86 (6.7)	15.85 (-6.0)
3511	Pharmac-euticals	7.01	158.05	202.84 (28.3)	217.91 (7.4)	254.12 (16.6)	282.12 (11.0)	314.74 (11.6)	309.09 (-1.8)
3143	Bidi	3.85	190.09	221.91 (16.7)	247.37 (11.5)	289.04 (16.8)	299.36 (3.6)	310.18 (3.6)	339.95 (9.6)
3123	Sugar	2.78	178.12	170.89 (-4.1)	201.76 (18.1)	246.22 (22.0)	167.75 (-31.9)	123.34 (-26.5)	151.71 (23.0)
3411	Paper	2.26	103.08	104.74 (1.6)	105.41 (0.6)	96.63 (-8.3)	96.11 (-0.5)	78.78 (-18.0)	53.57 (-32.0)
3141	Cigarettes	2.10	88.98	81.74 (-8.1)	89.83 (9.9)	123.36 (37.3)	115.15 (-6.6)	132.03 (14.7)	141.17 (6.9)
3713	Re-rolling Mills	1.91	58.72	66.54 (13.3)	118.43 (78.0)	195.76 (65.3)	169.35 (-13.5)	184.33 (8.8)	206.67 (12.1)
3533	Soap & Detergent	1.74	82.17	93.39 (13.6)	104.85 (12.3)	126.55 (20.7)	133.48 (5.5)	138.85 (4.0)	130.78 (-5.8)
3214	Silk & Synthetic	1.59	102.99	119.97 (16.5)	132.70 (10.6)	128.46 (-3.2)	164.47 (28.0)	188.84 (14.8)	227.07 (20.2)

Source: Bangladesh Bureau of Statistics
Note : Figures in parentheses are annual growth rates (calculated by the author).

Table 8

Changing Levels of Effective Protection for Major Export Industries

(Percentages)

Sector	Effective Rates of Protection (ERP)						Percentage Change in ERP between 92/93 & 97/98
	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	
Jute textile	98.2	93.5	81.0	55.7	56.0	48.4	-50.7
Garments	237.2	130.0	84.1	53.7	57.4	65.4	-72.4
Tea	82.7	85.1	66.0	48.7	48.8	46.4	-43.9
Leather & Leather products	98.6	87.3	42.3	20.7	15.8	8.8	-91.1
Fish	78.4	45.3	45.1	28.4	28.5	27.9	-64.4

Source: ERP estimates by Banghladesh Tariff Commission based on 1992-93 Bangladesh I-0 Table

Table 9

Changing Levels of Effective Protection for Major Import-Substituting Industries

(Percentages)

Sector	Effective Rates of Protection (ERP)						Percentage Change in ERP between 92/93 & 97/98
	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	
Fertilizer	-5.6	-2.2	-5.0	-3.6	-3.0	0.4	170.1
Cloth: Mill	189.7	147.5	131.6	98.0	110.2	86.2	-54.6
Pharmaceutical	1.5	-2.2	-2.5	-2.6	-1.4	0.7	-53.3
Sugar & Gur	96.3	42.3	52.3	51.1	51.4	40.0	-58.5
Paper	68.3	74.1	48.8	25.4	22.7	12.7	-81.4

Tobacco Products	133.6	69.9	89.7	85.0	86.7	81.9	-38.7
Steel & Basic Metal	40.9	27.2	27.4	25.1	24.6	25.0	-38.9

Source: Bangladesh Tariff Commission

Table 10

Growth Rate and Real Wages in Agriculture

Year	Agricultural Growth Rate (%)	Real Wage Rate Index in Agriculture (1969/70 = 100)
1990/91	1.6	95
1991/92	2.2	98
1992/93	1.8	105
1993/94	0.3	106
1994/95	-1.0	103
1995/96	3.7	104
1996/97	6.4	109
1997/98	2.9	107

Source: Ministry of Finance (1999)

Table 11

Trend of Total Unemployment

	LFS 1989	LFS 1990-91	LFS1995-96
Civilian labour force (million):			
Male	29.7	31.1	34.7
Femal	21.0	20.1	21.3
Total	50.7	51.2	56.0
Unemployed population (million):			

Male	0.4	0.6	0.9
Female	0.2	0.4	0.5
Total	0.6	1.0	1.4
Unemployment Rate (%) :			
Total	1.18	1.95	2.50
Male	1.35	1.93	2.59
Female	0.95	1.99	2.35

Source: BBS, Labour Force Survey 1989, 1990-91 and 1995-96

Table 12

Sectoral Distribution of Employment

(million workers)

	LFS 1989		LFS 1990-91		LFS 1995-96	
Agriculture	32.6	(65.1%)	33.3	(65.9%)	34.5	(63.2%)
Industry	7.8	(15.6%)	6.5	(12.9%)	5.2	(9.5%)
Manufacturing	7.0	(14.0%)	5.9	(13.0%)	4.1	(7.5%)
Services	9.5	(19.3%)	10.4	(21.2%)	14.8	(27.3%)

Source: Calculated from LFS data
Note : Figures in parentheses are respective percentage shares in total employment

Table-13

Status in Employment

	LFS 1989	LFS 1990-91	LFS 1995-96
Self employed	29.6	26.8	29.6
Employees	9.5	11.7	12.4
Day labourers	15.1	13.9	17.9

Unpaid family workers	45.8	47.2	40.1
Not reported	-	0.4	-
Total	100.0	100.0	100.0

Source: BBS, LFS data

Table 14

Estimated Growth of Formal and Non-Formal Emkployment during 1983/84-1995/96

(in percent)

Sector	Estimated non-formal employment as per cent of total employment in 1983/84	Estimated non-formal employment as percent of total employment in 1995/96	Growth rate of formal employment during 1984-96	Growth rate of non-formal employment during 1983/84-1995/96
All sectors	96.4	88.4	13.7	2.3
Agriculture, forestry & fishery	99.4	99.8	-6.9	1.9
Manufacturing	81.8	4.6	19.4	-18.2

Source: BIDS (1997), P 30

Notes : 1. Percentage shares of non-formal employment in total employment in 1983/84 and 1995/96 have been calculated by the author using data available in BIDS (1997)

2. Formal employment is defined as employment in establishments employing 10 and more workers.

NOTES

1. Notable studies are : World Bank (1990), World Bank (1996), World Bank (1999), Syeduzzaman (1991), Islam (1991), Rashid (1993), Rahman (1992), Sobhan (1995, 1996, 1998).

2. These data have been taken from, World Bank (1990).

3. See, World Bank (1990).

4. The analysis in this section draws heavily on information available in, World Bank (1990), World Bank (1992), World Bank (1993), World Bank (1998, Report No.17455-BD) and World Bank (1998, Report No.17453-BD).

5. See, Syeduzzaman (1991).

6. See, Rashid and Rahman (1998).

7. The analysis presented here is based on data contained in Bakht (1998).

ANNEXURE TABLE 1

Summary of Structural Adjustment Policies

Policy (1)	Objectives and Targets (2)	Strategies and Measures (3)	Timing of Measures (4)
1. **Trade and Industrial Policy**			
Investment sanctioning	Liberalize and simplify investment procedures		1986/87 onward
Tariff Reform	Improve efficiency in traded goods sector	Rationalize import regime	Ongoing
		Reduce and narrow the band of net effective level of protection for textiles and steel on the basis of TIP study	1986/87-1988/89
	Reduce disparities of effective protection	Reduce level and rationalize structure of tariffs in the **textile, steel and engineering**, chemical and **electronics** industries	1987/88 onward
		Reduce maximum customs duties to 20% for raw materials, 75% for intermediate goods and 100% for finished goods	1987/88 onward
		Continue reducing number of rates of customs duty and sales tax	1987/88 onward
		Reduce maximum tariff rate (other than for specified luxury goods) to 100%	1990/91
		Further action to be taken to reduce maximum tariff rate and compress duty schedule. One-fifth	1992/93 onward

		of items with rate above 100% were reduced to 75%. Further action needed.	
(1)	**(2)**	**(3)**	**(4)**
		Simplify tariff schedule to a 6-digit level of classification and reduce number of different tariff rates to no more than six	1991/92
		Curtail special concessions and exemptions on customs duties and sales taxes	1990/91 onward
Import Restrictions	Facilitate import of raw materials, intermediate goods and capital goods to encourage industrial production	Eliminate negative and restricted lists for industrial imports, except for items controlled for reasons of religion and public safety and a small number of highly sensitive items.	1986/87 onward. Complete by July 93
		Phase out requirement that barter facilities must be fully used before imports under any other financing sources are allowed	1987/88
Industrial export promotion	Provide free trade status for exporters	Remove restrictions on all required imports for direct and indirect exporters	1986/87
		Simplify procedures for obtaining duty exemption/drawback and grant autonomy	1986/87 onward
		Provide additional infrastructure for Export Processing Zone	1986/87 onward
	Ensure improved export credit finance	Prepare and implement plan to strengthen provision and guaranteeing of export credit	1987/88
	Promote backward linkages Encourage growth and diversification of non-traditional exports	Extend coverage of back to back leters of credit to all products and all indirect exporters Eliminate all export subsidies other than on jute in 1989/90 and phase out jute subsidies	1987/88 Ongoing 1990/91-1992/93)
		Remove all import restrictions on items reguired	1990/91

		by exporters	
		Extend bonded warehousing facility to all exports	1990/91
(1)	**(2)**	**(3)**	**(4)**
2. External Sector Policy			
Exchange rate management	Strengthen the balance of payment position	Exchange rae management will remain flexible to improve competitiveness and promote export diversification	Ongoing/ 1990/91 onward
	Unification of dual exchange markets	Steadily increase the proportion of external transactions conducted in the secondary exchange market	1986/87-1988/89
3. **Monetary Policy and Financial Sector Reform**		Narrow spread between official and secondary market rate to 2 per cent	November, 1988
Interest rates	Liberalize the structure of interest rates	Move towards a more market-determined level and structure of interest rates; adjust monthly	1988/89 onward
		Allow banks to charge different lending rates based on borrower credit risk	1990/91 onward
		Phase out interest rate subsidies	1990/91 onward
Financial sector reform	Improve operation of the financial system and credit recovery	Setting of annual overall recovery targets subject to close monitoring Establish targets for repayment by 100 defaulters of loans from state-owned banks.	1986/87 onward
		Meet targets for repayments by the largest 100 defaulters of loans from NCBs	1990/91 onward

		Introduce legal and administrative changes necesary to take action against loan defaulters	1988/89
	Strengthen rural credit institutions		1986/87-1987-88
(1)	**(2)**	**(3)**	**(4)**
	Encourage development and deepening of financial sector over the medium term	Identify and implement medium-term reform programmes based upon Banking Commission recommendations	1986/87-1988/89
	Strengthen financial institutions	Strengthen bank supervision and establish Legal Department in Bangladesh Bank.	1987/88 onward
		Improve the loan classification system to identify non-performing debt and provide adequate provisioning for debt	1988/89
		Raise the minimum requirement for paid-up capital and reserves for nationalised commercial banks	1988/89 onward
		Increase bank autonomy by allowing private sector participation in state-owned banks	Ongoing
		Recapitalise NCBs. Strengthen bank supervision by Bangladesh Bank	1990/91 onward

Source: PFP 1986/87-1988/89, PFP 1988/89-1990/91, PFP 1990/91-1992/93, PFP 1991/92-1993/94, PFP 1992/93-1994/95 for SAF & ESAF of IMF as compiled in Bhattacharya and Titumir, 1998.

ANNEXURE TABLE 2

Industrial Sector Adjustment Credit (ISAC) II Matrix of Policy Actions

Policy Objectives (1)	Recent Measures Taken (2)	Further Actions Under Credit (3)
Component I : **Import Regulation and Taxation**	Commitment in principle to efficient industry, export acceleration and liberalized tariffs, in **Industrial policy 1991**	Public announcement of medium-terms goal of trade reform; effective protection reduced to low levels prevailing in internationally competitive developing countries
Liberalization and rationali - zation of the import regime to remove controls and distorted incentives and facilitate trade and efficient production	GOB policy to remove auto-export bias in trade regime over 5 years stated in FY93 Budget speech; agreement that this implies effective protection reduced to low levels prevailing in internationally competitive developing countries	
A. Import Controls Removal of prohibitions and administrative restric- tions and requirements other than reasonable cont- rols for non-trade reasons	Replacement of positive list with negative & restricted lists in 1985, covering many of the QRs in the IPO by 4-digit code. These lists combined as the Control List (CL) in 1989. No objection certificate introduced but removed 1991. Phased reductions, leaving 193 HS-4 codes on CL plus about 130 groups of other IPO restrictions in IPO text in June	Implementation of the removal of : a) all but agreed CL items b) all but agreed, codified IPO text items c) passbooks d) import functions of CCIE not needed for retained QRs and e) permit activities of sector Ministries with

	1992. Controls on pharmaceutical inputs/packaging reviewed. GOB agreement to abolish most CL code items & IPO text provisions including passbooks & other procedures not needed for the retained controls	consequent restructuring of CCIE/BOI/other agencies' functions Removal of remaining controls apart from agreed non-trade requirements.
(1)	**(2)**	**(3)**
B Tariff Structure Compression and reduction of rates and simplification of instruments in the protective elements of import taxation to remove bias among users/importers, industries, stages and scales of production, and direction of sales	ISE-supported rationalization during 1988-90 but maximum customs duty (CD) rate remains 150% with 200-350% for 12 luxury product groups; development surcharge (8%) & regulatory duty replaced by 10% increase in most CD rates below 100%, and a few exemptions/Concessions removed in 1991. GOB approval of FY93 steps towards and FY94 rules for rationalizing CE/LF/AIT schedules: a) CD as the only protective instrument in import taxation (VAT/SED trade-neutral); b) No user-defined CD rates; c) Eight CD levels: 0,7.5, 15, 30, 45, 60, 75 & perhaps 100%, with * Zero for specified non-trade reasons, * 7.5 for specified primary inputs, * 15/30/45 for most raw/semi/final goods,	Implementation (by OTS publication) of agreed LCA/Permit fee and AIT changes plus following CD rate changes: a) apart from 4 agreed product groups, all now above 100% to less than or equal to 75% (most or 100% (some) b) about half (by CY 91 import value) of now at 100% to 75% or less, c) about one-quarter (by CY91 import value) of now above 50% to below 50%, including significant inputs to (a) and (b), d) all now below 7.5% to 7.5% or 15% except some agreed items at zero, e) consolidation to eliminate distinctions between users (all) and between similar products within HS-4 headings

	d) LCA/permit fee applied as temporary revenue measures in FY93; e) Advance income tax applied to all taxpayer importers.	(most). Implementation (by publication) of: (a) dual CD maxima : • 75% for NTC - approved, time bound industry adjustment programms (perhaps 100% in a few agreed cases),
1	**2**	**3**
		* 50% for other imports (acceptable revenue considerations permitting), (b) other CD adjustments needed to make effective protection moderate for most activities, any exceptions being explicitly on the basis of NTC recommendations (c) elimination of LF
C. Trade-neutral Taxes Development of consump-tion taxation to replace revenue-justified clements to protection tax instru- ments, and removal of protective elements in the consumption tax	VAT legislated & executed in 1991 to replace import sales tax (ST) and domestic excise duty (ED) but imposed only on imports of textiles and some other domestic products exempt; supplementary excise (SED) on a few products GOB approval of: (a) rules for SED at several rates on significant range of final goods to help offset possible revenue loss from CD decreases	Implementation (by OTS publication) of trade reatrality for levies other than CD/LF/AIT with satisfactory schedules for VAT, ED (for VAT-except domestic textiles) and SED. Implementation (OTS) of: (a) Imposition of trade neutral taxation of textiles; (b) Revised SED schedule to accommodate CD reduction from 75/100/greater than 100% to

instruments	(b) plans for trade-neutrality for textiles (partial in FY93)	45/60/75%.
D. Import Administration	Various measures including computerizing customs entry and voluntary PSI initiated in 1992 and instituted on trial basis.	Various actions including satisfactory NBR arrangements operational for reconciling assessment/receipts data, training NBR staff, and satisfactory procedures and operation of voluntary PSI scheme.
1	**2**	**3**
E Protection Analysis Development of public capacity to measure, to assess, and to provide appropriate and intended levels and pattern of industry assistance	Among other things, decision in principle taken in 1991 to establish more autonomous, better staffed National Tariff Commission (NTC), and Cabinet "approval with amendment" of draft legislation in May 1992	Among other things, satisfactory operation of NTC and completion of FY93 studies/hearings/reports on: a) industries most affected by the tariff rationalization b) "sensitive" imports now subject to QR, c) others agreed in setting the FY93 work programme, and d) first annual report with general protection review
F. Export promotion strategy	Strengthening of EPB, and GOB adoption and public announcement of comprehensive Bangladesh Export Development Strategy 1992-2000	Satisfactory concrete steps to relax regulatory environment, possibly including bans on re-export & consignment sales; Satisfactory implementation of further measures under BEDS.

G. World-priced inputs Removal of the effects on export production costs of fiscal instruments intended to protect domestic market production or tax domestic consumption	1. Strengthening of the Duty Drawback system and making it easier through setting "flat" DD rates for 335 products and reducing maximum processing time. 2. Special bonded warehouse (SBW) facilities extended to 2 non-garment firms on trial basis. 3. Approval and public announcement of arrangements for SBW improvement/expansion to any industry.	Satisfactory operation of improved/expanded SBW scheme
1	2	3
H. Exchange controls Liberalization of the exchange policy regime to promote domestic produc- tion and facilitate interna tional business transactions	1. Return to flexible management in 1991 2. Removal of requirement for approval of transactions falling within transparent BB/BOI guidelines for remittance of dividends and capital gains, local borrowing of working capital by foreign invested firms, etc. 3. Announcement of 10% export proceeds retention allowance (5% for garments)	1. Flexible management of the exchange rate to allow the exchange rate to help, in part, protect production during tariff rationalization. 2. Satisfactory implementation of (a) the recently announced relaxation and streamlining of exchange controls; and (b) automatic access to foreign exchange for domestic firms' foreign training & consultancy expenses. 3. Continued satisfactory operation of flexible exchange management. 4. Satisfactory implementation of further relaxation of exchange controls.

Source: *Report and Recommendations of the President of the International Development Association to the Executive Directors on a Proposed Credit in the amount for SDR 72.2 million to the People's Republic of Bangladesh for a Industrial Sector Adjustment Credit,* World Bank Report No. P-5816-BD, October 2, 1992 (as reported in Bhattacharya and Titumir, 1998)

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