

Trade Policy Review Body

TRADE POLICY REVIEW

BANGLADESH

Report by the Secretariat

This report, prepared for the second Trade Policy Review of Bangladesh, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from the Government of Bangladesh on its trade policies and practices.

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Document WT/TPR/G/68 contains the policy statement submitted by the Government of Bangladesh.

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SUMMARY OBSERVATIONS**(1) ECONOMIC ENVIRONMENT**

1. During the early 1990s, Bangladesh made considerable progress in stabilizing and liberalizing its economy. As a result, inflation was much lower than previously, and average annual real GDP growth in 1992-98 was above 5%, largely led by exports involving ready-made garments (RMGs). Indeed, one of the most striking features of Bangladesh's trade is that textiles and particularly clothing dominate exports: their combined share grew from 70.4% in 1992 to 83.5% in 1998; by contrast, jute, which had previously been Bangladesh's main export, comprising around half of total exports through the mid-1980s, accounted for only 6% in 1998. This dramatic change in the composition of exports is the consequence of Bangladesh's increased integration into the multilateral trading system.

2. Agriculture still accounts for 30% of GDP while employing 63% of total labour force. The RMG-dominated manufacturing sector and services, accounting for 9% and 61% of GDP, respectively, have been the sources of the economy's growth.

3. A major development, in March 1994, entailed the liberalization of the exchange regime for current international transactions. However, an appreciating real effective exchange rate has threatened to undermine Bangladesh's export competitiveness, particularly vis-à-vis South-East Asian garment manufacturers, and therefore constitutes a threat to future export-led growth.

4. Whereas annual government expenditure has averaged around 14% of GDP during the review period, tax revenues have averaged only 7.5%, which is very low both by international and neighbouring countries' standards. (The ratio of taxes to GDP is even lower if one includes the underground economy, which is thought to account for roughly half of GDP.) With other

sources of revenue amounting to approximately 2% of GDP, the outcome is a persistent central government budget deficit of around 5%. The weak revenue base jeopardizes the Government's ability to undertake essential social expenditures on health and education, etc., which would help to alleviate poverty, and to provide reliable basic infrastructure. The overall fiscal position of the public sector as a whole (that is, consolidated to take into account non-financial, state-owned enterprises) is even worse, owing to weak performance of these enterprises. Their operations are sustained largely through government-guaranteed borrowing from state-controlled banks, official external donors, and an accumulation of domestic and external arrears.

5. On the structural policy front, the Government has continued to pursue, inter alia, trade liberalization, financial sector reform, and privatization, while maintaining in legislative terms one of the most liberal foreign direct investment (FDI) regimes in South Asia. However, in the face of severe political difficulties and civil unrest, which manifested themselves in frequent nationwide strikes ("hartals") costing the country at least 30 working days in 1999 alone, the impetus for structural reform seems to have waned. Moreover, between 1997/98 and 1998/99, real GDP growth dropped from 5.3% to 4.2%. This was partly the consequence of a sharp drop in export growth (from 17.1% to 2.9%), which was initially due to the devastating floods that covered a third of the country, but exacerbated by recurrent power shortages, inadequate port facilities, and other infrastructural bottlenecks, as well as disruptions owing to nationwide strikes. At the same time, inflation increased owing to a surge in food prices, again caused by the floods. As the food supply situation improved and non-food inflation moderated, inflation began to fall.

6. Unfortunately, real annual GDP growth, averaging around 5% during the review period, has not been sufficient to make much of a dent in the poverty that pervades

Bangladesh; GDP per capita in 1998/99 was only US\$345, among the lowest in the world. More than one third of Bangladesh's population of 127 million still lives below the poverty line, and more than half is classified as poor. Given Bangladesh's high incidence of poverty, its dense population, and its vulnerability to natural disasters, including periodic flooding and cyclones, food security is a major policy objective of the Government. Bangladesh is a large recipient of foreign aid, a substantial portion of which entails food.

(2) TRADE POLICY FRAMEWORK

7. The Ministry of Commerce (MOC) is responsible for coordinating trade policy matters through its agencies, as well as in consultation with other Ministries and governmental bodies; national committees are formed to address specific issues on trade and industrial development. Private sector representatives, including business groups and academic institutions, are consulted in the policy-making process through their participation in the national committees. A major institutional change involves the upgrading of the Tariff Commission under the purview of the MOC; the Commission is now empowered to conduct anti-dumping and countervailing investigations.

8. Bangladesh extends most-favoured-nation (MFN) treatment to all trading partners and has taken steps to amend its legislation in the light of its obligations undertaken in the context of the Uruguay Round, including in the areas of customs valuation, anti-dumping and countervailing measures, and protection of intellectual property rights. However, Bangladesh has found it difficult to meet its WTO notification requirements. Bangladesh is a leading voice among least-developed Members in the WTO as regards their specific needs and concerns as well as the difficulties they face.

(3) TRADE POLICY MEASURES

9. Since 1992, Bangladesh has continued to liberalize its trade regime, by, inter alia,

greatly reducing tariffs and eliminating some quantitative restrictions on imports. It has also considerably increased the transparency of its trade regime. Nonetheless, the regime is still characterized by a certain lack of transparency (including ambiguity) as regards the application of certain trade and trade-related measures (notably customs administration, tariff concessions, advance income taxes on imports and exports, import surcharges, subsidies and other assistance, competition policy, and the regulatory framework). This provides considerable scope for administrative discretion, and even corruption, which in turn increases the uncertainty and costs of trading with and doing business in Bangladesh. At the same time, lack of transparency distorts market signals that are necessary to ensure an efficient allocation of resources, preventing Bangladesh from reaping the full benefits from trade liberalization and what would appear to be one of the most liberal FDI regimes in South Asia.

10. The customs tariff is the main instrument of Bangladesh's trade policy. It is also the Government's principal source of revenue, accounting for nearly one third of total taxes. During the period under review, Bangladesh has made considerable efforts to simplify and rationalize the tariff structure by reducing the number of tariff bands from 15 in 1992/93 to 5 in 1999/2000, and lowering the maximum tariff rate from 300% to 37.5% during the same period. While nominal applied MFN tariffs have fallen by more than half, from an average of 58% in 1992/93 to 22% in 1999/2000, tariff protection is still high and applied rates vary widely. Thus, the tariff constitutes a potentially important impediment to competition and therefore an obstacle to the efficient allocation of domestic resources. At the same time, the wide dispersion in nominal tariff rates provides considerable scope for misclassification of imports by customs officials. Moreover, the lack of bindings and wide gaps between applied and bound rates impart a degree of unpredictability to the tariff regime. The existence of a number of tariff concessions,

some based on end-use, may require importers to consult more than one document in order to ascertain the applicable tariff rate, which adds to the uncertainty and opacity of tariff assessment. Further protection and unpredictability has arisen because customs valuation has not always been based on transaction prices; recently, the authorities have taken steps aimed at bringing customs valuation into line with WTO norms.

11. Tariff reform has resulted in a considerable fall in the overall level of effective protection, and has also reduced the dispersion in effective rates of protection (ERPs). Nevertheless, ERPs still vary widely across sectors; the export-oriented textiles and clothing sectors, together with processed food and tobacco products, are accorded high levels of effective protection. The RMG sector, has flourished, however, because it has been insulated from the tariff regime; it has also greatly benefited from Bangladesh's export promotion measures and preferential access to U.S. and EU markets.

12. State involvement in trade has been greatly reduced, and all countertrade and special trade arrangements have been abolished since the last Review. However, tariffs are augmented by a multiplicity of other border charges and, in some instances, the discriminatory application of internal taxes, all of which are tantamount to tariffs and can raise nominal protection by one third. While the overall number of banned or restricted import items, including those for trade and non-trade reasons, has been reduced considerably, they account for 11.7% of HS 8-digit tariff lines in 1999/2000. Trade-related bans or restrictions remain on agricultural and textile products.

13. To mitigate the adverse impact on exporters' competitiveness of high tariffs, various other charges, and import restrictions, exporters benefit from an array of measures, including concessional tariffs, a duty drawback system, special bonded warehouses and export processing zones. As a result, the trade regime is complex. In addition, direct

subsidies are provided to exporters of textiles and clothing, and were recently extended to exporters of some other products. Furthermore, tax relief of 50% is allowed for income generated by exports.

14. Since its last Review Bangladesh has further opened up many of the state-dominated sectors to private investment; the sectors include essential infrastructure, such as telecommunications, power generation, and transport. While the foreign investment regime is liberal, with no limitations on foreign equity participation or repatriation of profits, lack of investment in these and other sectors, has clearly hampered Bangladesh's economic development.

15. In an effort to encourage investment, the Government offers a wide range of open-ended tax incentives, notably tax holidays and accelerated depreciation. However, the effectiveness of such incentives in attracting investment is doubtful, particularly in the absence of fiscal transparency, which would involve a detailed account of tax revenues forgone, and systematic evaluation of the impact of these incentives in relation to forgone taxes. The existence of incentives complicates tax administration and taxpayer compliance, while increasing the scope for tax avoidance and evasion, both of which are reflected in Bangladesh's low overall level of tax collection relative to GDP.

(4) INFRASTRUCTURAL SERVICES

16. Inefficient provision of essential services has constituted a major impediment to the smooth functioning of the Bangladesh economy. A weak financial system hampers economic growth, for instance, by restricting access to the financing of exports and investment. Insufficient and unreliable telephone connections and energy supplies can disrupt production of goods and services, while poor transportation and port services hinder international trade and the domestic distribution of goods. This lack of reliable basic infrastructure discourages foreign investment in Bangladesh. Many of these

basic infrastructural services have long been provided by state-owned enterprises, most of which are inefficient and often loss-making, employ outdated equipment, and are unable to meet the essential needs of the economy. Thus, the cost of doing business in Bangladesh is unnecessarily high, which impairs the competitiveness of firms operating there.

17. *The natural gas and power sectors have attracted large FDI inflows in recent years and offer great potential to the Bangladesh economy. Given its considerable reserves, the gas sector could boost industrial and agricultural production through increased power generation and fertilizer production, and may eventually offer the opportunity for exports of gas in various forms. Bangladesh's scarce power generating capacity, which has impeded the country's production capacity, has been increased by FDI in the sector.*

18. *Despite the Government's decisions to open up infrastructure (and other) services to private domestic and foreign investment, it has so far failed to make use of the GATS framework, which could help build investor confidence with regard to Bangladesh's commitments to liberalization of state-dominated services. While it has made some commitments in the tourism and travel-related services and telecommunications, these were merely a commitment to the status quo.*

(5) OUTLOOK

19. *While barriers to access in export markets are undoubtedly obstacles to Bangladesh's economic development, the main obstacles are home-grown. Notwithstanding the immense opportunities offered by Bangladesh, including its relatively cheap and abundant labour, potentially large market, and one of the most liberal FDI regimes in South*

Asia, FDI continues to be discouraged by a number of problems. These include frequent strikes, inadequate basic infrastructure (notably power, telecommunications and transportation facilities) and resulting bottlenecks, slow pace of privatization, an inefficient financial system, an institutional environment that is bureaucratic and corrupt, political uncertainty, and a worsening law and order situation. These factors tend to increase the cost of doing business in Bangladesh, thereby impairing the competitiveness, not just of foreign-owned enterprises, but also of domestically owned enterprises. Clearly, there is a pressing need to create the broad political consensus necessary to address these problems through structural reforms. Such reforms might usefully include further trade liberalization, although Bangladesh appears to be reluctant to undertake such reforms because of what it views as the slower pace of liberalization by some of its main trading partners.

20. *While Bangladesh has escaped the worst effects of the Asian crisis, the depreciation of the crisis-hit countries' exchange rates may well mean that it will face intensified competition from these and other countries, particularly in respect of labour-intensive RMGs. With textiles and clothing dominating its exports, and the bulk of those exports going to the European Union and the United States, there is a need for Bangladesh to diversify both its export base and export markets. At the same time, the phasing out of preferential access to these markets and the full integration of all textile and clothing products into the GATT 1994, scheduled for 1 January 2005, will require Bangladeshi RMG exporters to increase efficiency, improve product quality, and ensure that their products are competitively priced.*