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EXPORT PERFORMANCE AND EXPORT POLICY :

SOME INTERIM RECOMMENDATIONS

ABDUR RAB
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POLICY IMPLEMENTATION AND ANALYSIS GROUP (PIAG)
Adamjee Court, Motijheel, Dhaka

A
Ministry of Industries, Government of Bangladesh
United States Agency for International Development
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1. Introduction

This paper is not intended to be a long one, which had to be prepared with a very short notice. The PIAG project only very lately came to know about the process the Export Promotion Bureau had undergone to elicit and compile recommendations from various concerned trade and industrial bodies for possible improvements in the current two-year (1991-93) Export Policy and about a set of recommendations formulated by the EPB itself for the same purpose. It is gathered that the Government will, on the basis of these recommendations, shortly finalize its decisions with respect to the revision of the Export Policy for the next two-year term. It seems that the PIAG project could also make some useful contribution to this revision task. Given the extremely tight time schedule, an attempt is made in this paper to offer some recommendations along with a brief evaluation of the recent export performance record and the existing export policy.

2. Recent Export Performance Record

A quick look at the export information presented for four years of the last 6-year period in Table 1 shows the following features:

* Average annual rate of overall export growth over this period was 13% in current US dollar terms. Growth in real terms was less.

* Whatever export growth has taken place so far is mainly accounted for by a spectacular growth shown by readymade garments. Growth of other exports has been either absent or negative as in the case of jute and jute goods and frozen shrimps, fish and froglegs, lack-lustre as in the case of leather and leather goods, tea, and many non-traditional items (details on the latter not shown in the Table), or high as in the case of urea fertilizer and other non-traditional exports whose share in total exports is still too low to make any significant impact on total export growth.

* The export base is still very narrow and product diversification to a satisfactory extent is yet to take place. The future export prospects are handicapped considerably by the lack of (or negative) growth of jute and jute goods and frozen food, which account for a sizeable share of total exports. In such an event, it requires other non-traditional exports to grow at a fast enough rate to ensure a satisfactory overall export growth.

TABLE 1

Recent Export Performance by Selected Product Groups
1986/87 - 1991/92

(Export Figures in Current US$ Million)

Product Group	1986/87	1989/90	1990/91	1991/92	% of Total 1991/92	Ave.Annual Growth 1986/87-1991/92 (%)
Readymade garments	298.67	609.32	735.63	1064.00	53.38	28.93
Leather and leather products	134.82	178.89	137.29	148.84	7.47	2.00
Frozen shrimps, fish, froglegs	136.20	137.84	141.80	130.53	6.55	-0.85
Jute and jute goods	405.54	455.91	461.99	387.13	19.42	-0.88
Tea	28.66	39.48	43.21	32.43	1.63	1.80
Urea	4.18	17.04	36.32	21.35	1.07	38.56
All others[a]	64.69	85.22	161.31	208.82	10.48	26.41
Total	1073.76	1523.70	1717.55	1993.10	100	13.17

[a] Details of export items for major portions are not available.

Source of basic figures: World Bank, Report No. 11569-BD, Bangladesh: Implementing Structural Reform, March 24, 1993. Statistical Appendix Table 3.3, p.163 (Original source cited: Export Promotion Bureau).

In this situation, it will be unwise to be complacent about the overall export performance record of recent years. Export growth has no doubt narrowed the import-export gap in recent years, but still the import-export gap is nearly 40%. Also, this masks the depressed and sluggish levels of imports and investment activities of recent years. To meet Bangladesh's longer-term development needs at an accelerated pace as well as to service the evergrowing foreign debt liabilities, it is crucial that Bangladesh's exports grow at a significantly faster rate than at present.

3. A Brief Review of Current Export Policy

The recent export performance record suggests that Bangladesh needs to vigorously pursue export development through expansion of existing exports as well as through product and market diversification efforts. In an economy which is characterized by a very low per-capita income and a limited domestic market, a strategy of successful export development is critical to Bangladesh's prospects for satisfactory future industrial and economic development. This is admitted by the Government in its recently adopted Export Development Strategy spanning a period up to the year 2000. The 1991 Industrial Policy also places more pronounced emphasis on export development as the key to rapid industrialization of Bangladesh.

However, this needed and professed policy stance has not yet been reflected in the existing two-year (1991-93) Export Policy. The current overall policy environment makes no real departure from past policies in terms of a fundamentally required clear and unambiguous shift to export-oriented strategy. The shift would require that export production and import-substitution industries are given roughly equal policy treatment. Because of the continued highly restrictive import policy (with still fairly extensive quantitative restrictions and high tariffs) which provides high effective protection to most production activities for the domestic market, export activities are discriminated against and discouraged. The existing restrictive import policy which owes to the import substitution strategy of development which was mainly being pursued for long hurts export (and also low-duty import-substitution products or products with large tariff concessions) in two ways:

- it provides much higher policy-created effective protection (assistance or profit) to production for the domestic market than to production for export; and

- it appreciates the exchange rate (over-values the domestic currency) which harms both export production and production of low-duty domestic market-based goods.

Thus if the Government seriously means adoption of an export-oriented strategy of development, the required first priority policy action of the Government would be to expeditiously carry out the ongoing program of import liberalization by lifting quantitative import controls which are still fairly extensive (and in some cases very important as in the case of textile products) and substantial moderation of the high tariffs and compression of the wide spread of tariffs. Unless and until this reform is carried out, export promotion efforts and also importantly, development of backward linkage industries would remain highly constrained.

In the current Export Policy, there are provisions for a wide array of special incentives for exports which together only partly compensate for the anti-export bias created by the restrictive import policy regime. Available estimates of the net anti-export bias (after taking into account export incentive effects) for recent years suggest that the Real Effective Exchange Rate (REER) for imports is about or over 30% higher than that for exports[1]. The anti-export bias may have increased after January 1992 with the abolition of the XPB (Export Performance Benefit) scheme which used to confer a substantial benefit on exporters until a few months before its abolition.

In so far as the effect of the restrictive import policy on the exchange rate is concerned, TIP (Trade and Industrial Policy Reform Program Project) estimated that the taka remained overvalued by some 22%[2]. This overvaluation remains in place despite exchange rate devaluations so long as the restrictive import policy is not significantly liberalized.

In this existing policy environment, pre-tax rates of return due to policy-created different effective rates of protection (ERPs) to different industries are highly distorted among industries.[3] In this situation, even 100% income tax exemption may not help to promote (export and low-duty) industries based on genuine comparative advantage. It is perhaps this fundamental reason why foreign investment has not still started to flow into

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1 See Abdur Rab, Value of Bangladesh's Policies to Promote Exports, World Bank, Dhaka, June 10, 1989 and World Bank, Bangladesh: Restructuring Options for the Jute Manufacturing Industry, February 25, 1992.

2 See TIP, Planning Commission, Overview of Policies to Promote Exports and Backward Integration, February, 1986 and this author and M.M. Haque, "Updates on the Standard Conversion Factor", TIP, Planning Commission, May, 1987.

3 See for an idea of these distortions, this author, Value of Policies to Promote Exports ..., op.cit. and TIP, Overview of Industrial Assistance Policy in Bangladesh and Recommendations for Reform, Planning Commission, March 1987.

the economy in any significant amounts despite the very liberal stance of the Government Industrial Policy.

In addition to restrictive import policy, the existing restrictions on foreign exchange use also hurt the exporters. Though foreign exchange regulations have been recently liberalized to an extent, the restrictions are still perceived by local and foreign firms as excessive. They surrender foreign exchange after export at one rate and have to buy foreign exchange for imports at a higher rate and at times the difference entails a considerable loss for them. A recent change allows exporters currently to retain foreign exchange in an account up to 5% to 10% of their earnings to meet their contingency foreign exchange expenditures like foreign travel and imports of materials and spare parts, etc. Foreign exchange expenditures are still subject to certain control on account of royalties and technical fees. Foreign exchange expenses incurred for engineering services are not allowed. Access to foreign exchange for domestic firms' foreign training and consultancy expenses is also not automatically assured. Flow of foreign exchange funds out of the country is still not freely allowed to foreign investors and non-resident Bangladeshis working abroad. Further relaxation of the existing foreign exchange controls is both possible and desirable, especially in view of the more liberalized practices being followed by other countries like Sri Lanka, Pakistan, India and Nepal. In Sri Lanka, exporters are no longer required to surrender foreign exchange to the Central Bank and those who have kept foreign exchange abroad are no longer mandated to bring back this exchange. This revolutionary reform has not only given a further boost to exports (Sri Lankan export performance is already much more satisfactory than that of Bangladesh) but appears also to have served to stop capital flight and encourage more inflows of foreign investment. Pakistan has very liberal rules for free flow of funds into and out of the Pakistani market. India has recently made its currency fully convertible on trade account. Nepal has followed suit. Certainly further liberalization of still remaining foreign exchange controls will provide an added boost to export-oriented activities including encouragement of foreign investment in such activities.

Now turning to the special export incentives in place, almost all major elements of which have been in place since the mid-eighties, these incentives comprise the following:

* Provision for allowing access to imported inputs for export industries, imports of which are otherwise restricted.

* Allowing duty-free access to imported inputs through either special bonded warehouse (SBW) or some form of duty drawback (DD) facilities to ensure availability of imported inputs at world prices.

* Provisions for allowing access to export credit at subsidized rates.

* Allowing a duty concession on imported machinery.

* Allowing back-to-back LC facilities to certain activities for importing on deferred payment (suppliers' credit) basis.

* Using an export credit guarantee scheme (ECGS) to insure banks/exporters against certain risks of nonpayment of export proceeds.

* Granting a special income tax exemption.

* Using a special cash compensation for readymade garment firms who do not enjoy SBW or DD facilities.

These special incentives which have been offered especially for non-traditional exports with some exceptions have been supplemented by some occasional flexibility applied to the exchange rate, some relaxations applied to the existing controls on the use of foreign exchange and some product-specific promotional measures. In addition, a significant special incentive enjoyed by the exporters especially during the late seventies and the whole of eighties was an XPL/IEC (Export Performance License/Import Entitlement Certificate) later changed into an XPB (Export Performance Benefit) system based on a dual exchange rate system. This incentive consisted in a special premium over the official exchange rate. During some months before the dual exchange rate system was converted into a unitary one, the XPB premium lost much of its importance as an incentive for the exporters and finally when in January 1992, the unitary exchange rate system was adopted, the XPB got abolished automatically.

Some major problems with, undesirable side effects or drawbacks of this current export policy are as follows:

* Lack of universality and automaticity or product-specificity of the special incentives. SBW facilities are applicable to 100% export oriented firms in a few product cases. DD facilities at flat rates which are preferable to DD at

actual rates are available at present to some 460 product items. No satisfactory system of DD is at present available for indirect exporters. Subsidized credit is not available to all intending exporters on asking and is hardly available to indirect exporters. Duty concession on imported machinery is available only to 100% exporting firms and not available to other exporting firms on a pro-rata basis. Back-to-back LC facilities are available to a very limited group of products like readymade garments, where suppliers' credit is available for a limited period within which importing and production and exporting can be completed. The cash compensation scheme is applied only in the case of readymade garments using local fabrics. At present there seems to be a confusion among manufacturers whether this scheme is in place at all.

* Inadequacy of tax offset received on imported inputs due to side payments or delays involved in receiving such privileges or due to exchange rate differences or increases in dollar value of inputs. No compensation is received for tax or protection element embodied in locally produced inputs used in export production.

* To the extent tax offset on imported inputs is effective and the fact that no compensation is available for taxes/ protection on domestically produced inputs - both these factors (accompanied by the facts that most locally produced inputs are high-cost due to protection) strongly discourage local production of inputs that can be imported and the incentive system has thus an in-built strong bias against development of industries having backward linkages with export industries.

* Significantly different incentives are currently being maintained for Export Processing Zones (EPZs) and the rest of the country.

In a nutshell, the existing system of special incentives for exports work imperfectly and superimposed on the system of high protection being accorded to most local market-based production activities, the system is encouraging import-dependent export industries and high protection receiving industries and discouraging indigenous raw material-based or domestically produced intermediate input-based industries as well as those import-substitution industries which receive low-duty protection from imports. Small-scale export producers who are placed at a relative disadvantage vis-a-vis larger-scale producers to avail of the current incentives seem particularly to be little helped by the current incentive system. These are too serious distortions being created in the incentive system for production to be based on sound comparative advantage basis.

There are still numerous other problems with the current incentive system:

a) The incentives lend considerable discretionary administrative powers to official authorities administering the system and create rent-seeking opportunities at official levels charged with issuing special privileges (SBW licences, DD facilities, duty concession on imported machinery, issuing of special utilization certificates or 'certified analysis cards' for imported materials.

b) The system creates opportunities for abuse of the incentives often in collusion with government officials, leading to over-import of inputs with tax-free privileges, over-invoicing of exports, etc.

c) There has been a revolving 30-million US dollar export development fund in place to help exporters with access to imported current inputs. The use of this fund is reported to have grown satisfactorily, al beit from a zero base. However, there is no export promotion fund in place to help the exporters with term financing or to help their product development, access to improved technology or other export promotional activities. Even use of the current Export Development Fund (EDF) probably needs a more accelerated promotion with an expansion of the Fund.

d) The ECGS in place to help banks providing export credit or exporters receiving such credit against certain risks of non-payment of export proceeds is reported to have run into some snags with banks refused insurance cover by the ECGS cell at times. The use of such a system which has been very successfully developed in other countries seems to have lost some credibility with banks and exporters in Bangladesh. Also, the premium cost of the insurance scheme which is designed to be borne by the exporters themselves is a discouragement in itself for the exporters to make more extensive use of this scheme.

e) Currently export incentives are available when exports are effected against firm irrevocable letters of credit (LCs). Exports on consignment (on sale or return basis) currently remain banned. Also paradoxically, exports of samples to export fairs or on other occasions remain subject to certain value limits. Even re-export of unprocessed imports remains restricted, subject to special permission from case to case. In addition, exporting of a good number of product items is banned or restricted or allowable with special permissions.

f) SBW facilities are not satisfactorily applied to exporters not operating under back-to-back LC credit arrangements.

g) Service industries such as shipping, construction, hoteling, etc. are not currently provided many of the export incentives.

h) There is currently a value added restriction applied with respect to imports of raw-materials in the readymade garment industry. The mandatory value addition content was raised from 25% to 30% in certain garment categories. The new policy has reportedly led to discouragement of production and export of high-value garments with high-value fabrics (and styles) which need to be imported. The current mandatory value addition restriction does not seem to make any economic sense since a 10% value added on a US$ 50 silk shirt provides much greater foreign exchange than 30% value added on a US$ 10 T Shirt.

i) There are complaints received from exporters about high duties being maintained on spare parts, on raw materials for packaging industries, on refer vans used in frozen fish industry, etc. on which tax offset is either not available or inadequately available.

j) The duty-draw back system does not cover the 2.5% LC or import permit fee for exporters.

k) Exporters also complain about too much import controls being exercised on samples of restricted import items needed to be imported for introducing and improving export product designs.

l) Even the concessional duty on machinery is hurting export competitiveness. Exporters are currently required to first pay duty at 7.5% and later receive a duty draw back of 5%.

m) Even though the Government has recently announced a general waiver of the requirement of importing materials and exporting by Bangladeshi flag vessels for export industries, it seems it is not being fully implemented especially in the case of importing of materials for export industries.

n) Export producers also complain about very high peak hour electricity charges.

o) The Government has reduced the imported raw material content of knitwear industry from 75% to 51%. This has reportedly led to shortages of raw-materials, especially yarn, for this fast growing industry.

p) Exporters have been subjected by the last budget to the requirement to pay advance income tax at a rate of 0.5% of gross export earnings. This is working as a disincentive, especially for small-scale export firms whose tax liability is negligible and for new firms who enjoy full exemption from income tax due to the tax holiday privilege received by them.

It is worth noting that the Export Promotion Bureau (EPB) has in its recent submissions of recommendations for export policy revision to the Ministry of Commerce has identified 8 of the 18 special incentive facilities professed by the 1991-93 Export Policy, which still remain unimplemented. These include:

- rationalization of the validity period for export credit at concessional rates.
- lifting of the Import Permit/LCA fee;
- reduction of gas and electricity rates;
- enhancement of the tax holiday period;
- establishment of an export promotion fund;
- abolition of overdue interest on export credit (after 90-day period expires); and
- providing a rebate on the insurance premium on ECGS.

EPB also notes that two important facilities, in addition to the eight, XPB and cash subsidy do not exist at present.

4. Recommendations

Admittedly, the foregoing analysis identifies numerous problems with the current Export Policy which need to be squarely addressed in the next Policy. In addition to the inadequacy/ undercoverage of the special incentives, exporters are also being hurt by a too conservative (insufficiently flexible) exchange rate policy. On this policy, PIAG would present a separate paper soon. However, we would make some recommendations on this policy in this paper also along with a brief outline of the key considerations for reform of this policy.

For successful implementation of the Government's recently announced Export Development Strategy, the Government needs to particularly focus on six key areas:

* expeditions implementation of the ongoing import liberalization program;

* further liberalization of the foreign exchange regime;

* necessary extensions/improvements of the current DD system to ensure availability of world-priced inputs at all levels of export production;

* necessary improvements of current policies and introduction of new ones to promote backward linkages, especially with the large and rapidly growing export garment sector;

* reintroduction of an appropriate cash compensation system for direct and indirect export producers who fail to receive full offset for taxes embodied in or protection on domestically produced inputs used by them; and

* more flexible exchange rate management.

A. <u>Recommendations on Import Liberalization</u>

The 1991-93 Export Policy as amended up to July 1, 1992 briefly mentioned about the need for import policy liberalization to facilitate the access to imported raw materials for export production. The next Export Policy should also mention and underscore the importance of import liberalization to narrow the current gross anti-export bias of the restrictive import policy which confers much higher rates of <u>effective protection</u> (or trade-created effective assistance) on production for the domestic market than on production for export and which also adversely affects the export sector by distorting (overvaluing) the exchange rate. In the last Budget Speech of the Finance Minister, it was mentioned that the Government policy aim in this area is to remove the anti-export bias of the trade regime over a period of five years bringing down effective protection to low levels prevailing in internationally competitive developing countries. The next Export Policy should categorily mention that the Government would pursue a program of import liberalization as envisaged and supported by the World Bank under ISAC-2.[4]

B. <u>Recommendations on Exchange Regime Liberalization</u>

EPB in its submissions to the Ministry of Commerce has recommended reintroduction of a scheme of partial convertibility of foreign exchange: allowing exporters to retain a larger part of their earned foreign exchange in their foreign exchange accounts (than at present) and giving them the option to sell it in the open market, the part varying initially from 50% of value addition in low-value added exports (like readymade garments, hosiery products, etc.) to 50% of gross export earnings in other export cases.

This proposed scheme has no doubt a merit but it discriminates against export producers who need larger foreign exchange to meet their genuine import requirements. In fact, distinction on the basis of domestic addition content is neither necessary nor desirable since low-value-added activities (like readymade garments, electronic and engineering goods, leather finishing on the basis of imported leather, shoe making and other leather goods and assembling activities which are labor-intensive) may and does indeed enjoy greater comparative advantage than certain high value-addition but high-domestic cost activities and since such distinctions usually entail complexities in administration. PIAG would therefore recommend convertibility of foreign exchange at the rate of 50% to 60% for

[4] This program comprises the following components (a) phasing out of all quantitative import restrictions except those which are required for such non-trade reasons as health, security or religion; (b) satisfactory simplification of import procedures; (c) significant moderation of the high tariffs; (d) compression of the many tariffs to a few rates; (e) upward revision of the two low tariffs; (f) removal of all concessions and distinctions between users and similar goods (at HS 4-digit level); (g) making all other levies on imports trade - neutral by putting them also on domestic production; and (h) obviating the necessity of using tariff values through proper rationalization of customs administration. It may be noted in this connection that this program of import liberalization is much more gradual than was recommended by the Government's Trade and Industrial Policy Reform Program (TIP) project.

all exporters alike for an initial stage and full convertibility of foreign exchange for all export earners within a few years.

Our other recommendations for further relaxation of foreign exchange controls are:

a) Remove all current restrictions on withdrawals on foreign exchange accounts operated by foreign investors, expatriate workers, exporters and Bangladeshi wage earners working abroad.

b) Remove the existing limits on foreign exchange usable for such expenses as royalties and technical fees; allow foreign exchange expenses on account of engineering services and automatically allow domestic firms' foreign training and consultancy services.

c) Remove current limits on foreign exchange use for travels by exporting firms and foreign investors.

C. Recommendations on SBW/DD Facilities

In this area, PIAG would strongly urge the Government to implement the reforms as envisaged under the World Bank-supported ISAC-2 program. That the Government would indeed implement this program may be reiterated in the next Export Policy. In particular, the following elements need to be ensured:

* Continued expansion of coverage of the DD system at flat rates at a satisfactory speed: by 50 a month or other satisfactory number; and

* Continued expansion of the SBW scheme by its extension to cover non-back-to-back LC imports and to any activity by allowing effective provisions for advance imports and including other simplified import procedures and including 100% exemption/suspension of duty on imported machinery for 100% export industries and pro-rating of duty suspension on machinery for other export industries.

The Government recently reduced the first duty payment on imported machinery to be made by 100% exporting firms from 10% to 7.5% but did not suspend it altogether.

PIAG would also support the EPB recommendation that the 5% duty on imported raw hides be completely exempted, which would provide a boost to the export - oriented leather and leather related industries. A duty on imported raw hides is unnecessary as domestic hides go mostly into export production. The VAT should continue to remain, however, which will not affect export production since it is zero-rated for export production.

We also endorse EPB's recommendations for payment on DD at flat rates on FOB export value basis in foreign exchange terms rather than on taka value basis (as exporters can lose on account of fluctuations in the exchange rate) and for extension of the DD scheme to indirect and commercial exporters.

D. Recommendations on Promoting Backward Linkages

The most unfortunate aspect of the current export policy is that even though Bangladesh has by now established itself as a leading supplier of readymade garments in the world market and uses as much as 700 million meters of fabrics, only 2% to 3% of this is taken from the domestic producers. Currently numerous problems stand on the way of development of backward linkages from this industry as well as from other industries. Even an increase of the current usage of domestically produced fabrics to say 10% of the total would make a significant difference to the development of the textile sector of Bangladesh. Detailed investigation of the problems holding back backward linkages from the garment industry has been documented in the World Bank - sponsored recent study on the textile industry and a package of recommendations have been offered in that study to improve the backward linkages.[5] We support these recommendations and their acceptance by the Government for incorporation in the next Export Policy. The key recommendations are summarized as follows:

a) Assure full free-trade status to all stages of textile production, destined for the export market, including sales to the garment sector and for this:

  - issue provisional SBW licenses to all producers asking for such licenses who intend to supply fabrics and/or yarn (the latter to composite fabric and garment producers) to readymade garment (RMG) units, without requiring firm (irrevocable) export orders;

[5] See Charles Draper et. al., Bangladesh: Report on the Textile Industries Restructuring Study - Phase 1, Washington, D.C., May 9, 1992.

- introduce promptly a well-devised system of DD at flat rates for textile products;

- allow duty-free imports of spare parts for all intending export producers of textile products;

- withdraw the provisional 7.5% duty payment and the final 2.5% concessional duty payment on capital machinery for 100% export-oriented textile units and withdraw the existing commercial duty rate on such machinery on a pro-rata basis for less than 100% export producers of textiles; and

- provide for locally purchased inputs for which SBW or DD arrangements are not available, a special "tax compensation" payment to the purchasing RMG units, but subject the present standard 15% rate to review for ensuring appropriate compensation for different goods, such as dyed and finished fabrics of different kinds (cotton, cotton-polyester-blended, silk, etc.) and yarn of different kinds/counts, depending on the taxes embodied in them and their inputs.

b) Expeditiously institute trade policy reform for the textile sector and for this:

- Withdraw all bans and other quantitative restrictions on imports of textile fabrics including grey fabrics and imports of certain textile inputs (such as some textile spare parts) that still exist. (Currently importation of grey fabrics is subject to permission required to be obtained from the Ministry of Textiles on recommendation from the EPB, a requirement which has served to restrain the importation of fabric for finishing and supply to RMG units.)

- Impose the 15% VAT on all imports and all stages of textile production sold in the domestic market, which besides providing a much needed significant additional government revenue, would make VAT trade-neutral and serve to moderate the levels of effective protection on textile yarn and fabrics (on the local production of which there is no VAT at present while their imports face the VAT), which are already far too high for the good of either the industries or consumers; and

- Carry out tariff reform by moderating customs duty rates to a maximum of 35% on all fabrics including grey fabrics, 20% on all intermediate inputs such as yarn, dyes and chemicals and sizing materials and spare parts and 10% on primary inputs of raw cotton and man-made fibres and raw silk and cocoons. (Reform/ rationalization of the tariff is of utmost importance to narrow the current wide anti-export bias of the sector).

c) To bring the effective protection levels for the export products closer to those enjoyed by domestic sales of such products, for the time being (if the tariffs proposed above were adopted), a special cash compensation at the rate of 20% of the value of supplies to RMG or 10% of the FOB value of direct exports may be appropriate and should be introduced. (This is required to assure a near 'extended neutral status' to RMG suppliers and textile exporters. The mere free trade status does not ensure this status so long as the domestic textile sector remains protected significantly.)

d) Restructure the ownership pattern of the existing textile sector as quickly as possible and encourage investment in efficient activities and for this:

- privatize the BTMC mills and for this undertake a well-devised strategy and prompt program of privatization;

- resolve the outstanding debt of the privatized and semi-privatized mills so that they can raise the investment and working capital needed to bring their operations up to export quality standard; and

- vigorously promote and facilitate foreign investment in establishing weaving, knitting and/or finishing facilities.

e) Finally, (this recommendation is not included in the Textile Study cited), to enable fabric suppliers to supply on credit basis to RMG units (a special feature of this business as RMG units can and usually do pay after export orders are executed and export proceeds received), extend the facilities of the Export Development Fund (EDF) to the suppliers of fabrics to RMG units.

These recommendations for promoting backward linkages have been made specifically with respect to the textile sub-sector because of this sub-sector's current overwhelming dominance in export performance and possible significant potential contribution to Bangladesh's future growth prospects. It hardly needs mentioning that an appropriate set of similar measures obviously need to be undertaken to promote backward linkages in general from all export industries.

Besides the set of recommendations mentioned above, improvements in other export policies including exchange rate reform, industrial policy liberalization/deregulation and other investment and efficient production promotion measures will also help promote backward integration.

E. Recommendations on Exchange Rate Reform

Maintaining the exchange rate at an appropriate level at any given time and making the exchange rate sufficiently flexible over time depending on the changes in the factors that should influence it constitute a macro-policy requirement of critical importance to economic development in general and export promotion in particular. What a better price for a product does for it in terms of promoting its production and growth, so does a better exchange rate for the traded (both export and import-substitution) sectors of an economy.

As mentioned already, a separate PIAG paper on this subject will be shortly presented to the appropriate Government authorities through the proper channel. Briefly, some key reasons/considerations for which urgent reform of the current exchange rate policy is called for are summarized below:

- Maintaining a fixed parity system to a hard currency like US dollar and infrequently moving the parity serves in practice to frequently keep the exchange rate at an appreciated level in tandem with appreciation of the greenback following from fluctuations in the international currency market. (Currency appreciation which gives less taka per unit of foreign exchange discourages the growth of traded sectors of the economy.)

- Historical analysis suggests that in contrast to the policy being followed by Bangladesh, most other developing countries with which Bangladeshi products compete either in the export market or in the domestic market via imports/smuggling follow more aggressive exchange rate policies. The current policy has reduced Bangladesh's competitive edge in the export market and created significant selling problems for several of Bangladesh's industrial and agricultural products in the domestic market in competition with smuggled products. In recent years, the Bangladesh taka has become highly misaligned with the Indian currency. This misalignment is particularly affecting Bangladesh's industrial production and growth because of a significantly large volume of official and unofficial trade that flows between the two countries as well as due to Bangladesh's significant competition with India in exports of jute, leather goods and tea.

- Satisfactorily flexible exchange rate management is an essential and critical element of the market and export-oriented development strategy. Some inflation may inevitably follow from such a policy but concern for growth overshadows that for inflation. Domestic inflation, if it takes place, is a reason by itself for continuing flexible exchange rate management to preserve the necessary inducements to the traded sectors of the economy.

- Importantly, Bangladesh should implement at an accelerated pace its ongoing program of import liberalization through dismantling of all trade barriers and intensive tariff reform. Exchange rate devaluation in appropriate doses will be an important adjunct to import liberalization policy by mitigating the adverse disprotecting effects of import liberalization on domestic production while import liberalization on its part will mitigate the possible effects of exchange rate devaluation on inflation.

- Exchange rate reform is also called for on considerations of high real wage cost levels relative to productivity in many industries in Bangladesh and possible further wage cost hikes that are likely to follow.

- Appropriate doses of devaluation will also help to reduce the staggering losses in some public sector industries like jute, textiles, sugar, etc.

- Given current and expected levels of foreign aid, a significant increase in the public sector development program which is necessary to accelerate the present moderate growth rate has prospects of significantly worsening the current comfortable balance of payments situation which has been possible due to depressed and sluggish levels of investment and importing activities.

Our recommended policy options for exchange rate reform are as follows:

First Preferred Option

Unpeg the Bangladesh taka from the US dollar and allow it to float freely against all currencies. (Pakistan did it more than a decade ago. India and, following India, Nepal have made their currencies fully convertible on trade account.)

Alternative Second Option

First devalue taka by an appropriate dose to align it with the Indian currency at an appropriate level, say, at the level existing in 1991 before India devalued its currency by 21%.

Then partially convert taka, say, up to 50% to 60% of export earnings as a prelude to the indication that full convertibility will follow later.

Full convertibility will leave the exchange rate to be decided by market forces. In case of partial convertibility, a secondary free foreign exchange market will develop which will help to promote exports.

F. Other Miscellaneous Sort of Recommendations

These are offered as follows:

(a) Extend the incentives applicable for EPZ industries to 100% export industries outside EPZs. (This recommendation has been made by EPB also).

(b) Reduce duties to low levels on spare parts, raw materials on packaging industries and refer vans used in frozen fish industry, about which manufacturers complain that tax offset is either not available or inadequately available.

(c) Institute proper enquiry into the reasons for slow utilization of the ECGS and take steps to improve the utilization, including provision of a subsidy on the premium cost on the insurance coverage.

(d) Abolish the 2.5% Import Permit/LCA fee on imports for export - oriented industries exporting more than, say, 50% of their production.

(e) Ensure full implementation of recently announced general waiver of flag vessel requirement for exporters of all products.

(f) Significantly reduce peak hour electricity rates for export-oriented industries exporting more than, say, 50%of their production.

(g) Establish soon an export promotion fund to provide term financing, promote new product development, improve technology, promote market development and undertake other export promotional activities.

(h) Allow re-export of imports for all cases rather than on case to case basis without requiring prior permission from any official authorities.

(i) Extend all existing export incentive benefits to shipping, construction, hoteling and other service exports.

(j) Appropriately relax the mandatory domestic value addition requirements applied to readymade garments and knitwear, which are perceived to be too restrictive of growth of these industries.

(k) Withdraw the advance income tax (of 0.5% of export earnings) from the exporters.

(l) Freely allow export of samples without any value limit.

(m) Freely allow import of samples for export industries, even if such goods are on the restricted import list.

(n) Abolish the existing ban on exports of a number of items, unless such a ban is justified on genuine non-trade reasons such as environmental or security reasons. (Current Export Policy has a list of 27 product groups which are subject to export ban or exporting of which requires special prior permission from concerned Government authorities.)