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ESTIMATES OF EFFECTIVE ASSISTANCE TO TEXTILE PRODUCTS:

1974/75 - 1987/88

WORKING PAPER NO. 7

HIID/ESEPP Working Papers, 1987-89

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*This working paper.

HIID/ESEPP Project

ESTIMATES OF EFFECTIVE ASSISTANCE TO TEXTILE PRODUCTS:

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ABDUR RAB

with the assistance of

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EMPLOYMENT AND SMALL ENTERPRISE POLICY (EPPA) PROJECT

PLANNING COMMISSION

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1. METHODOLOGY AND DATA USED

This paper attempts to look at the effective assistance provided by government policy measures to textile industry activities over a 14-year period, 1974/75 to 1987/88. Three kinds of effective assistance concepts have been used: effective rate of protection (ERP), effective rate of overall assistance on overall value added basis (ERA-1) and effective rate of overall assistance to non-wage value added (ERA-2). The first concept is well known and widely used which is defined as:

$$ERP = \left(\begin{array}{l} \text{Nominal assistance} \\ \text{to output} \end{array} \quad \underline{\text{minus}} \quad \begin{array}{l} \text{Nominal assistance} \\ \text{to intermediate} \\ \text{inputs} \end{array} \right) / \text{Value added}$$

The Trade and Industrial Policy (TIP) Reform Program has analyzed assistance to numerous industries in terms of ERPs. However, the analysis was not extended to cover a historical period.

The second concept ERA is defined as:

$$ERA-1 = \left(\begin{array}{l} \text{Nominal assistance} \\ \text{to output} \end{array} \quad \underline{\text{minus}} \quad \begin{array}{l} \text{Nominal} \\ \text{assistance} \\ \text{to intermedi-} \\ \text{ate inputs} \end{array} \quad \underline{\text{minus}} \right. \\ \left. \begin{array}{l} \text{Nominal} \\ \text{assistance} \\ \text{to labour} \end{array} \quad \underline{\text{plus}} \quad \begin{array}{l} \text{Nominal} \\ \text{assistance} \\ \text{to capital} \end{array} \right) / \text{Value} \\ \text{added}$$

The first concept does not capture the effects of government policies which affect the assistance to labour and capital inputs. The second concept is therefore employed to look at overall assistance to value added.

The third concept is defined as:

$$\text{ERA-2} = \left(\begin{array}{l} \text{Nominal} \\ \text{assistance} \\ \text{to output} \end{array} \right) \underline{\text{minus}} \begin{array}{l} \text{Nominal} \\ \text{assistance} \\ \text{to interme-} \\ \text{diary inputs} \end{array} \underline{\text{minus}} \begin{array}{l} \text{Nominal} \\ \text{assistance} \\ \text{to labour} \end{array} \underline{\text{plus}} \begin{array}{l} \text{Nominal} \\ \text{assistance} \\ \text{to capital} \end{array} \Bigg/ \begin{array}{l} \text{Value} \\ \text{added to} \\ \text{capital} \end{array}$$

The distinction between ERA-1 and ERA-2 is that the former expresses total assistance to overall value added while the latter does it in terms of non-wage component of value added or value added to capital. Some economists (for example, Schdolwosky) have used the latter concept in analysing industrial assistance since this concept represents the most direct effect on the operating surplus of entrepreneurs and hence the most obvious incentive to them. For computational formulae of these concepts and the assistance measures covered, the reader is referred to Sahota 1988.

The assistance measures covered include tariffs on imports, additional effect of the cost of importing due to importing under the wage earner scheme (WES) or barter arrangements wherever applicable, and scarcity premium, if any, on imports due to nontariff restrictions on such imports. The nominal assistance on output so derived is netted of the domestic excise tax on it, if any. The assistance to labor is taken in terms of the excess of the market wage over its shadow wage measured in border prices. The assistance to capital is available in various forms. If the product is sold in the export market, it is eligible for a concession in the taxes on imported machinery, for a subsidy in the interest payable on borrowing and for a rebate

in the income tax payable on income/profit earned. For domestic sale, it is normally entitled to only the tax concession available on imported machinery. Small enterprises are eligible for subsidized bank credit, but in practice there seems little evidence of their getting normal access to such credit. There is evidence that producers of handloom products buy yarn from yarn merchants on credit at an extra-ordinarily high interest rate. The excess of this interest cost over the market rate in the organized sector is taken into account as a negative assistance for estimating ERA-1 and ERA-2 for the handloom products.

All these assistance measures are estimated per unit of output. The assistance to capital is annualized by using an accounting interest of 10%. For estimating assistance on account of tax concession on machinery imports, the average effective tax on machinery imports not eligible for concessionary duties has been taken as the benchmark and the machine cost to output ratio has been assumed to be one. For estimating assistance on account of subsidized credit for exporters, the amount of borrowing involved has been assumed to be 80% of the FOB value of export. For estimating assistance on account of the rebate on income tax, the benchmark or normal tax rate has been assumed to be 40%, the rebate rate has been taken to be 60% of the benchmark tax rate, taxable profit rate has been assumed to be 50% of the value added to capital and reported taxable profit has been taken as 50% of the actual.

The products covered in this paper are cotton yarn 20, 32, 40, 60 and 80-count; mill-made cotton fabrics, average quality; cotton saree of fine

quality; cotton lungi of fine quality; cotton vests of average quality; polyester shirting of average quality and polyester suiting of average quality for domestic sale and cotton and polyester blended shirts for export sale. These products would represent main activities in the textile industry. Cotton saree and lungi are the major products of hand-looms, while polyester shirting and suiting are the major products of power looms. Cotton yarn and cotton mill fabrics are major products of the larger mill sector. Shirts and trousers are major products in the export readymade garments subsector. The cost structures of these two products are similar and the assistance policies affecting them are also the same. Hence the assistance to one of these two is being analyzed. The choice of cotton saree of fine quality and of cotton lungi of fine quality has been made as their cost structures looked more reasonable in terms of specific input-output relations. The sources of the cost structures used are as follows:

Cotton yarn and cotton fabrics	}	BTMC-supplied data of 1986-87
Cotton saree, lungi)	BIDS survey of 1986-87
Polyester shirting suiting grey)	TIP, 1983-84
Polyester shirting suiting, finished)	TIP, 1983-84
Cotton and polyester blended shirt)	TIP, 1983-84
Cotton vests)	TIP, 1983-84

BTMC: Bangladesh Textile Mills Corporation
BIDS: Bangladesh Institute of Development Studies
TIP: Trade and Industrial Policy (TIP) Reform Program

The information on various government policy measures has been collected from various government documents as cited in Sahota 1988. Shadow wages, standard conversion factor and specific conversion factors of certain non-tradeables which were estimated by TIP have been used. Information on observed quality-adjusted nominal rate of assistance on cotton yarn and cotton vests has been taken from the TIP while that on observed quality-adjusted nominal assistance on cotton saree and lungi has been taken from the BIDS. The quality adjustment has been done on the basis of observed differences in the market prices of imported and, competing domestically produced goods. Nominal rate of assistance has been derived after the border price of the imported good has been adjusted downward for the difference in quality with the domestic product.

II. THE ESTIMATED RESULTS

The estimated time series of effective assistance by different concepts refer to statutory assistance as distinguished from observed assistance. Statutory assistance is simply the assistance which is intended by the prevailing policy measures. On the other hand, observed assistance measures the assistance that is actually enjoyed by the recipient. Observed assistance is estimated only for the year for which the assisted cost structures of the individual products have been gathered. For estimating the assisted situations from the statutory point of view, the unassisted cost structure of the base year was used for all the years.

Assistance to Cotton Yarn

A. Observed Effective Assistance

Estimated observed assistance to cotton yarn of different counts for 1986-87 is shown in Table 1. Observed ERP and ERA-1 are at moderate to high levels on the lower-count yarns, 20s and 32s. Both ERP and ERA-1 are excessively high on the higher count yarns. ERA-2 looks fairly reasonable also in the case of 20-count yarn. However, in

Table 1

Observed Effective Assistance to Cotton Yarn
for Domestic Sale: 1986-87

(In percentage)

Effective Assistance/ Yarn Count	20s	32s	40s	60s	80s
ERP	47.8	124.9	423.1	234.4	332.0
ERA-1	31.1	86.1	322.8	191.0	260.0
ERA-2	75.1	NVA _k	NVA _k	NVA _k	NVA _k

NVA_k = Negative value added to capital at border prices.

the case of all other counts, ERA-2 cannot be estimated as unassisted value added to capital has turned out negative. This means that ERA-2 on these products is infinitely high.

B. Statutory Effective Assistance

Estimates of this assistance over 14 years, 1974/75-1987/88, are presented in Table 2. Two fundamental features revealed by these estimates can be noted. First, whatever measure is used,

Table 2

Statutory Effective Assistance to Cotton Yarn for
Domestic Sale: 1974/75-1986/87
(In percentage)

		Cotton Yarn by Count				
Year		20s	32s	40s	60s	80s
74/75	ERP	164.2	263.3	526.4	280.3	392.7
	ERA-1	147.5	225.0	426.2	236.0	320.0
	ERA-2	356.2	NVA _k	NVA _k	NVA _k	NVA _k
75/76	ERP	176.8	287.0	575.1	296.7	417.0
	ERA-1	160.1	248.2	474.8	253.0	345.0
	ERA-2	386.6	NVA _k	NVA _k	NVA _k	NVA _k
76/77	ERP	179.0	290.7	583.5	299.5	420.9
	ERA-1	162.3	251.9	483.2	255.0	349.0
	ERA-2	391.9	NVA _k	NVA _k	NVA _k	NVA _k
77/78	ERP	187.4	306.1	617.0	310.0	436.5
	ERA-1	170.7	267.4	516.8	266.0	364.0
	ERA-2	412.2	NVA _k	NVA _k	NVA _k	NVA _k

	20s	32s	40s	60s	80s
78/79 ERP	187.4	306.1	616.8	310.0	436.5
ERA-1	170.8	267.5	516.8	266.0	364.0
ERA-2	412.4	NVA _k	NVA _k	NVA _k	NVA _k
79/80 ERP	187.4	306.1	617.0	310.0	436.5
ERA-1	170.8	267.5	517.0	266.0	364.0
ERA-2	412.4	NVA _k	NVA _k	NVA _k	NVA _k
80/81 ERP	170.1	278.4	561.4	286.2	422.2
ERA-1	153.5	239.8	461.4	242.0	350.0
ERA-2	370.6	NVA _k	NVA _k	NVA _k	NVA _k
81/82 ERP	170.1	280.2	564.2	288.4	417.6
ERA-1	155.0	241.5	464.2	244.0	333.0
ERA-2	374.2	NVA _k	NVA _k	NVA _k	NVA _k
82/83 ERP	136.8	219.5	436.7	185.6	258.8
ERA-1	120.2	180.8	336.6	142.0	186.0
ERA-2	290.3	NVA _k	NVA _k	NVA _k	NVA _k
83/84 ERP	135.9	217.6	432.7	183.8	256.0
ERA-1	119.3	178.9	332.5	140.0	184.0
ERA-2	288.1	NVA _k	NVA _k	NVA _k	NVA _k
84/85 ERP	135.9	217.6	432.7	183.8	256.0
ERA-1	119.3	178.9	332.5	140.0	184.0
ERA-2	288.1	NVA _k	NVA _k	NVA _k	NVA _k

Year/Effective Assistance	20s	32s	40s	60s	80s
85/86 ERP	188.5	307.2	616.3	261.1	368.1
ERA-1	171.8	268.4	515.9	217.0	296.0
ERA-2	414.7	NVA _k	NVA _k	NVA _k	NVA _k
86/87 ERP	171.0	282.2	570.9	234.4	332.0
ERA-1	154.3	243.4	470.6	191.1	260.0
ERA-2	372.6	NVA _k	NVA _k	NVA _k	NVA _k
87/88 ERP	159.9	263.9	533.2	248.3	351.6
ERA-1	143.2	225.1	432.7	204.0	279.0
ERA-2	345.7	NVA _k	NVA _k	NVA _k	NVA _k

statutory effective assistance to cotton yarn has been all along excessively high. And second, there has been no significant variation in statutory effective assistance over time.

Assistance to Cotton Saree and Cotton Lungi

Statutory effective assistance to these handloom products during 1975/75 - 1987/88 is shown in Table 3. As in the case of cotton yarn, statutory effective assistance to cotton saree and cotton lungi has also been quite high over all years. There have been some noticeable fluctuations in the level of this assistance but it never went down below a considerably high excessive level.

In sharp contrast to a minimum statutory effective assistance of 171.6% to 162.6% ERP or 160.1% to 153.8% ERA-1 received by cotton sarees and cotton lungi during 1986-87, the actual observed ERP and ERA-1 received by these products during the same year are only 10.4% to -19.8% and -1.0% to -28.6%. Actual effective assistance received is found to be virtually non-existent or negative. The basis for estimating observed effective assistance for other years does not exist. It requires observation of prevailing market prices of the imported and locally produced products. However, even the one-year observed assistance demonstrates the effects of the existing anomalous assistance policies: high effective assistance provided to the input, cotton yarn, coupled with low effective assistance actually received on outputs due to the effects of smuggled sarees and lungis. Thus statutory effective assistance at excessively high levels has been of no effect for the handloom products, a feature which reflects the stagnant or deteriorating condition of this segment of textile industry in Bangladesh. To rejuvenate this industry, it is necessary to allow more liberal imports of cotton yarn with considerably less tariff on them and make the domestic spinning industry operate at a considerably more efficient level at a less level of effective assistance. Similar conclusions were drawn in TIP 1986 and Bangladesh Government Committee 1987.

Table 3

Statutory Effective Assistance to Cotton Saree and Cotton Lungi
for Domestic Sale: 1974/75 - 1987/88

(In percentage)

Year	Cotton saree			Cotton lungi		
	ERP	ERA-1	ERA-2	ERP	ERA-1	ERA-2
1974/75	240.5	224.3	498.5	227.8	213.0	367.2
75/76	236.4	220.2	489.4	223.8	209.0	360.4
76/77	236.4	220.2	489.4	223.8	209.0	360.4
77/78	236.2	219.9	488.8	223.6	208.8	360.0
78/79	236.3	220.3	489.5	223.7	209.0	360.3
79/80	307.7	291.6	648.1	289.9	275.2	474.5
80/81	385.9	369.8	822.0	362.2	347.6	599.2
81/82	387.7	371.6	825.9	363.7	349.1	601.8
82/83	195.9	179.9	399.8	184.5	169.9	292.9
83/84	266.7	250.6	557.1	250.2	235.6	406.1
84/85	409.3	393.3	874.1	332.3	367.7	633.9
85/86	388.5	372.5	827.8	364.5	349.8	603.1
86/87	171.6	155.6	345.8	162.6	148.0	255.1
87/88	177.2	161.8	358.2	168.0	153.7	264.4
186/87 observed	10.4	-5.6	-12.4	-19.8	-34.4	-59.3

Assistance to Mill-made Fabrics

For estimating effective assistance to these products, the 1985/86 cost structures of BTMC-made grey cotton shirting and finished cotton shirting were looked at. No calculation of effective assistance rates of any kind could be made in the case of grey cotton shirting, since overall value added, and naturally value added to capital also, turned out to be negative in the unassisted situation. It is a typical case of highly inefficient activity receiving infinite protection. The other case, that of effective assistance to finished cotton shirting, is shown in Table 4. Both statutory and observed situations show very high protection of this product. Note, however, that the cost structure of one year may not represent the normal pricing situation of BTMC's products, since on frequent occasions it is found to have unintended stockpiles and very limited pricing flexibility to clear them promptly. So although the statutory effective assistance rates can still be as high as shown in the table (ERP: 564.5% to 1366.9%; ERA-1: 499.8% to 1302.6%), those estimated as observed assistance rates for 1985/86 (ERP:415.1% and ERA-1:350.7%) are unlikely to be so high considering the plausible effects smuggling and competition among the producers have on textile products in general and considering the effects of fairly high protection received by yarn on woven fabrics in particular.

Table 4

Statutory Effective Assistance to Mill-made
Finished Cotton Shirting for Domestic Sale: 1974/75 - 1987/88

(In percentage)

Year	Finished Cotton Shirting		
	ERP	ERA-1	ERA-2
1974/75	828.9	764.3	NVA _k
75/76	829.7	765.0	NVA _k
76/77	829.6	765.0	NVA _k
77/78	828.9	764.3	NVA _k
78/79	828.9	764.6	NVA _k
79/80	1084.5	1020.2	NVA _k
80/81	1366.9	1302.6	NVA _k
81/82	1355.7	1291.3	NVA _k
82/83	674.3	609.9	NVA _k
83/84	933.0	868.6	NVA _k
84/85	1442.6	1378.2	NVA _k
85/86	1358.5	1293.8	NVA _k
86/87	564.5	499.8	NVA _k
87/88	572.0	507.0	NVA _k
1985/86 observed	415.1	350.7	NVA _k

Asistance to Polyester fabrics

These are mostly power loom products in medium to large units. The situation of effective assistance to polyester shirting, both grey and finished is shown in Table 5 and that of effective assistance to polyester suiting, both grey and finished in Table 6. The observed effective protection and assistance rates for the year 1983/84 for which the cost structure was available are high for shirting fabric (ERA-1:96.5% and 100.5%) and for the grey category of suiting fabric (ERA-1:106.5%) but not high for finished suiting (ERA-1:20.9%). The reported situation of finished Bangladesh-made suiting finding market across the border seems to lend some support to this relatively efficient production activity at a moderate level of actually realized effective assistance. In the case of the other products, it would certainly be desirable to have a situation of effective assistance of less than 100 per cent, but this situation is not so bad as in the case of many other import-substituting products studied by TIP.

The situation of statutory effective assistance shows as usual inordinately high protection for all the four activities. Historically, the assistance rates show some fluctuation and a marked decline in recent years which is reflective of the government's recent steps taken toward reforming the tariff structure. Tariffs together with quantitative restrictions on imports still remain high and need further moderation.

Table 5

Statutory Effective Assistance to Polyester Shirting
Grey and Finished for Domestic Sale: 1974/75-1987/88

(In percentage)

Year	Polyester Shirting Grey			Polyester shirting, finished		
	ERP	ERA-1	ERA-2	ERP	ERA-1	ERA-2
1974/75	302.0	288.5	636.2	326.9	314.8	620.6
1975/76	242.0	228.0	504.9	273.1	251.0	494.9
1976/77	242.0	228.0	504.9	273.1	251.0	494.9
1977/78	353.0	339.5	748.7	350.0	401.8	739.3
1978/79	466.0	452.6	998.0	501.2	513.3	988.1
1979/80	522.1	508.7	1121.7	563.9	576.0	1111.8
1980/81	346.9	333.5	735.5	495.0	507.1	975.9
1981/82	360.8	347.4	766.1	507.6	519.7	1001.0
1982/83	311.2	297.8	656.6	450.8	462.9	688.8
1983/84	310.5	297.1	655.0	449.2	461.3	885.6
1984/85	224.1	210.6	464.5	347.0	359.1	684.1
1985/86	211.1	197.6	435.8	335.2	347.4	660.9
1986/87	146.6	133.1	293.5	146.5	158.6	288.8
1987/88	152.6	139.1	306.8	155.4	167.6	306.4
1983/84 observed	109.9	96.5	212.8	112.6	100.5	198.1

Table 6

Statutory Effective Assistance to Polyester Suiting,
Grey & Finished, for Domestic Sale: 1974/75-1987/88

(In percentage)

Year	<u>Polyester suiting finished</u>			<u>Polyester suiting grey</u>		
	ERP	ERA-1	ERA-2	ERP	ERA-1	ERA-2
1974/75	n.e.	n.e.	n.e.	n.e.	n.e.	n.e.
1975/76	339.0	327.0	633.6	666.8	620.0	NVA _k
1976/77	339.0	327.0	633.6	666.8	620.0	NVA _k
1977/78	336.3	324.2	628.3	656.1	609.8	NVA _k
1978/79	512.1	500.0	969.0	1065.0	1018.8	NVA _k
1979/80	599.3	587.3	1138.0	1266.8	1220.6	NVA _k
1980/81	674.9	662.9	1284.5	1020.3	974.0	NVA _k
1981/82	697.7	685.7	1328.6	1105.3	1059.1	NVA _k
1982/83	620.6	608.6	1179.3	939.9	893.7	NVA _k
1983/84	615.6	603.6	1169.6	922.9	876.7	NVA _k
1984/85	484.6	472.6	915.8	686.8	640.5	NVA _k
1985/86	413.0	451.0	873.9	605.3	559.0	NVA _k
1986/87	204.8	192.8	373.5	402.8	356.5	NVA _k
1987/88	219.7	207.6	402.3	433.3	386.8	NVA _k
1983/84 observed	32.9	20.9	40.6	152.7	106.5	NVA _k

n.e. : not estimated; information on nominal protection on yarn is not available.

Assistance to Knit Fabrics

Statutory effective assistance for one of this product group, cotton vests for domestic sale as shown in Table 7 is also very high. The level is found to have considerably gone up in the eighties compared to what it had been in the earlier period. This depicts a peculiar situation and reflects an increasingly restrictive import regime affecting this product. However, paradoxically this is a product which is found to be negatively assisted as observed nominal protection on output is low enough and that on its main input, yarn, remains relatively high. Production of knit fabrics seems to be particularly suited to the comparative advantage of Bangladesh. Garments made of locally produced knit fabrics have already entered the export market. The situation of observed negative assistance for knit fabrics reflects an anomalous assistance policy structure which provides too high a protection to yarn.

Table 7
Statutory Effective Assistance to Knit Cotton Vests
for Domestic Sale: 1974/75-1987/88

(In percentage)

Year	ERP	ERA-1	ERA-2
1974/75	348.0	346.5	378.9
75/76	347.9	346.1	378.4
76/77	347.9	346.1	378.4
77/78	347.7	345.8	378.1
78/79	347.8	345.9	378.3
79/80	347.8	345.9	378.3
80/81	598.4	596.5	652.3
81/82	600.1	598.3	654.2
82/83	628.5	626.7	685.2
83/84	628.0	626.1	684.6
84/85	626.7	624.9	683.3
85/86	600.9	599.0	655.0
86/87	618.5	616.6	674.3
87/88	622.4	620.5	678.5
85/86 observed	-85.0	-86.8	-95.0

Assistance to Readymade Garments for Export

To analyze assistance to textile products for export, the product, polyester and blended men's shirts, has been chosen. Estimated effective assistance for this product is shown in Table 8. The level of assistance has been estimated under the bonded warehouse system which receives the largest assistance for export purposes. Unlike in the case of import-substituting products, the statutory assistance has been just moderate and close to the same as the realized one: by the sheer reason that it was moderate. Another peculiarity for this product is that overall assistance for it has been greater than effective protection due to a variety of assistance measures available to capital. ERP ranges between 0 and 38.4% while ERA-1 between 5.1% and 45.8%. Effective assistance for this product has been quite substantial during 1976/77 - 1981/82 and during 1983/84 - 1985/86. However, during 1982/83 and during the last two years, the effective assistance has gone down to inadequate levels, mainly because the premium of the wage earner's scheme exchange rate over the official exchange rate has considerably, declined in these years.

Table 8

Effective Assistance to Polyester and Blended Men's shirts
for Export: 1975/76-1987/88
(In percentage)

Year	ERP	ERA-1	ERA-2
1974/75	n.e.	n.e.	n.e.
75/76	0	5.1	6.7
76/77	28.9	35.8	47.2
77/78	38.4	45.8	60.4
78/79	35.7	43.0	56.7
79/80	35.7	43.0	56.7
80/81	29.1	36.0	47.5
81/82	25.8	32.4	42.9
82/83	1.8	7.0	9.0
83/84	18.7	24.9	32.9
84/85	23.2	29.7	39.2
85/86	22.0	28.4	37.5
86/87	8.6	14.2	18.8
87/88	8.3	13.8	18.2

n.e.: not estimated as information on the export incentives
was not fully available.

III: SOME MAJOR BROAD CONCLUSIONS

The foregoing analysis of assistance to several textile products enables us to draw some broad conclusions as follows:

1. Statutory measures translate into overly high effective assistance for all import-substituting products, but in reality only a few of them received assistance comparable to the level implied by the measures.
2. Actual or observed effective assistance is modest (or even negative) for a few products: handloom products; knit fabrics; and export products.
3. Statutory measures provide a low effective assistance to export products compared to import-substituting products. The incentive to exports has considerably come down in last two years mainly due to the decline in the premium of the wage earner scheme's exchange rate over the official one.
4. Relatively high assistance is realized by the spinning activity. This is an undesirable feature of the structure of assistance as it is hurting the overall development of the textile industry.

Historically, we can observe certain changes or fluctuations in the statutory level of assistance. However, this level has basically remained high throughout this period for the import-substituting products.

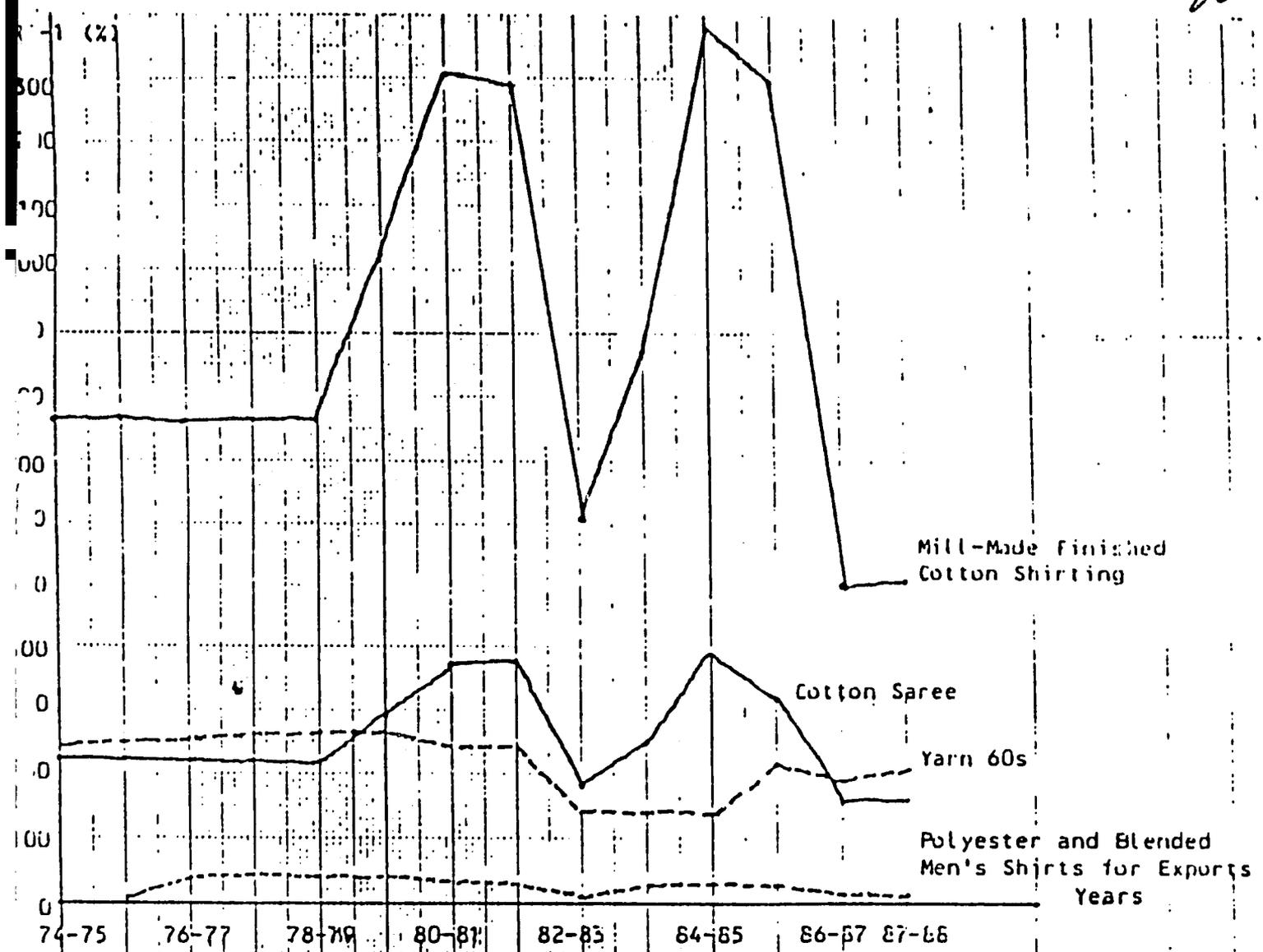


Fig. 1. --ERA-1 for chosen textile products.

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March 24, 1988

Professor Gian Singh Sahota
USAID
c/o American Embassy
Dhaka, Bangladesh

Dear Gian,

As I mentioned on the phone this morning, Tyler asked Klaus Lorch to look at Mr. Abdur Rab's paper, "Estimates of Effective Assistance to Textile Products: 1974/75 - 1987/88." As Klaus has worked on the textile industry in Bangladesh, we thought he was the most appropriate person.

In general, I will try to provide informed comments on papers that you send me. Often the comments will not be new to you, but we want to be sure that you have whatever benefit there is in them.

With best wishes.

Sincerely yours,

Donald Snodgrass

Comments on Mr. Abdur Rab's paper on
"Estimates of Effective Assistance to Textile Products:
1974/75 - 1987/88"

Klaus Lorch, H.I.I.D.

Mr. Rab probably did a diligent job estimating all the ERPs; given his long experience in this area he knows the measures, the tariff system and the textile/garments market well. I also like his idea to include assistance to labor and to capital.

The main problem, though in the irrelevance of many statutory effective assistance rates. Several times in his paper Mr. Rab himself points out the striking difference between observed and statutory ERPs. E.g., on page 17 he writes about the "paradoxical" situation of very high statutory ERP and negative observed ERP for knit fabrics. The underlying reason is the prevalence of "informal" aspects of business in the textile and garment industry. Official tariffs or quotas, interest rates, and labor cost are largely irrelevant.

First, the Ministry of Textiles itself concedes that in several years in the 1980s smuggling covered about one third of the domestic consumption of many yarns and of sarrees. Synthetic cloth is smuggled out to India, to large extent. Export garment firms make a killing from leakages out of their bonded warehouses. Mr. Rab tries to capture that smuggling in his observed ERP. Let's assume that he indeed managed to observe the market prices. The problem is that he has observed ERPs only for one single year. So his paper in facts boils down to ERPs for a dozen products in one single year -- the old TIP data. Even the trend of statutory ERPs over time does not necessarily mean a similar trend of observed ERPs. The latter depends largely on the efforts of the Government to cut down smuggling. The intensity of those efforts varies a lot, depending on political and personal factors such as the involvement of government officials in the smuggling.

Second, the main assistance to capital is not the tax concession for imports or the income tax rebate but the fact that long-term loans by Bangladeshi banks are rarely properly serviced. In fact the dividing line between a loan and a grant is very fuzzy in Bangladesh. About half the total loans outstanding of the two core development banks BSB and BSRS are overdue arrears. Sure, many debtors probably have to pay under the table part of what they save in debt service payments, but politically well-connected debtors, or debtors where debt collection would jeopardize many urban industrial jobs, seem to get away without side payments. Even the state-owned BTMC, the sole producer of yarn until 1982/83, has been paying only about half of its debt service on long-term loans. This problem doesn't show up in the ERPs. In particular ERP-2 should be strongly distorted by the debt collection problem.

Third, Mr. Rab measures assistance to labor as the difference between "market wage" and "shadow wage measured in border prices." To take a border wage as the shadow wage in the rest of the country is somewhat oversimplified, but admittedly it is hard to find a good shadow wage rate. The bigger problem is that wage rates don't adequately reflect the cost of labor from the company owner's perspective. Lack of discipline and

violence, together with politically connected labor leadership and lack of protection by the police, are crucial problems in medium and large mills. The result is a high number of security guards, high side payments to labor leaders, a substantial proportion of working hours lost for strikes, meetings or just idleness, or in fact loss of control of the mill itself (- several owners and managers have for months or years been unable to go to their own mill because of the physical danger-). The seemingly paradoxically high capital-intensity of new weaving mills in a country with low wages is evidence of their high real cost of labor. Labor costs are more than wages and social benefits, in Bangladesh.

Let me just add a few further, though comparatively minor, remarks.

One of the main policies in the 1980s was the privatization of textile mills, supposed to raise efficiency of spinning and weaving. But Mr. Rab's calculations for yarn and mill-woven cloth are based only on cost data from the public sector (T.I.P. 1983-84, BIMC - supplied data 1986-87).

Allegedly, equipment purchases (machinery and spare parts) are very frequently overinvoiced. Twenty to thirty percent overinvoicing is not uncommon. Which machinery prices have been taken as a basis for the ERP calculations?

The credit from yarn merchants to handweavers surely has "extraordinarily" high interest rates. But is this really a "negative assistance"? Is the "market rate in the organized sector" really the shadow rate of interest, in particular before 1983 when basically the whole banking sector was state-owned? Is the higher interest rate not a reflection of high risk and high administrative cost of lending to handweavers?

So far, Mr. Rab hasn't much discussed his findings.

In short, many statutory ERPs are irrelevant; the observed ERPs are so far only available for one single year; ^{and} the observed ERPs themselves are also probably heavily distorted by the problem of "informal economy" beyond mere smuggling.

Reply to Klaus

There is hardly any point in Klaus's comment that we were not aware of. We have already taken care of some of them since Rab's study was completed. Nevertheless, I appreciate Klaus's comments, which confirm some of our concerns, and for which I am thankful to him and to Don. I hope we will continue receiving comments on all reports we will be sending to HIID Headquarters in the coming months. That is the benefit, I recognize, of being a piece of HIID and being man-in-the-field on behalf of it. Clarification of a few points is in order.

We had hired the equivalence of one month's consultancy by Rab, with the main objective to learn as much about the TIP Project's methodology, procedures, and data as well as from Rab's experience, knowledge of the Bangladesh's price distortions and the ERP literature, a specimen analytical work on ERA by a TIP scholar, interaction, and the benefit of his scrutiny of the conceptual aspects and the relation I had specified. For even though the TIP Project's relation is a subset of the relation of this study, the latter is anchored upon the former. Dr. Rab's report was neither meant to contain full analysis, nor to be final on the textile industry or the topic. Yet, it is reasonably self-contained and detailed enough for us to invite comments, which will be relevant to our ongoing and future work. In fairness to Dr. Rab, it should be mentioned that the data, we are now using to elaborate upon his results, were not ready at the time Rab did his study.

The following are the replies to each of the points raised by Klaus. We are also analyzing several other policies and prices not appearing in Rab's work, but adding information about them will take us beyond replying to the comments. Accordingly, I will confine my reply to the specific comments only.

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Point 1: Statutory rates

Statutory effective assistance is useful, at least, to gauge changes in policies for their intended effects. In addition, if it is correlated with observed assistance in one (the TIP) year, it can tell a good deal about the actual assistance rates in other years, too.

We are, however, estimating actual assistance also for several products for all the years from 1973-74 through 1987-88. The actual prices of 3 major raw materials, power, and products (as well as weights of chemicals, packing materials in total cost, etc.) were calculated from the CMI by enterprise and by four-digit industry. Border prices are available from Foreign Trade Statistics of Bangladesh (an annual publication, each volume giving cif prices for imports and fob prices for exports for 3 years). Unfortunately, we have found the Foreign Trade border prices more suspicious than the CMI market prices. Only those products were analyzed from this source which passed the test of plausibility. This subsample, combined with the TIP estimates for one year, will be used to verify the correlation between the statutory and observed series.

We are not sure about Klaus's conjecture that statutory ERPs are more stable than observed ERPs. A common conjecture frequently heard here is that whenever a customs duty exceeds 50%, legal import is reduced to an insignificant fraction of total imports; smuggling becomes rampant.

Point 2: Debt default as grant

The suggestion has been widely discussed, though remains somewhat controversial. The relevant data about borrowers are weak. Knowledgeable persons tell us that kickbacks and related costs raise the real interest rates on defaultable loans from 10 percent to anywhere between 40 to 50 percent.

But we cannot use these hypothetical figures. Nevertheless, we have prepared the necessary ratios based on default-data and are in the process of handling this implicit subsidy.

Point 3: Shadow wage of labor

Not only the data on the application of labor laws and the extent of Govt's support to big business and big labor vis-a-vis small business and small labor as well as labor unrest and related practices are not available, they are also not easy to quantify. (I am trying to have some questions on such labor costs included in the forthcoming economic survey for future researchers, but the odds are heavy.) We believe the Rab methodology is sound and the estimates are relevant and plausible. Besides, so long as the left-out cost elements are additive rather than offsetting, their omission is innocuous. For, we are interested more in relative changes than absolute magnitudes. The calculated high cost, ^{relative to shadow price} of labor and subsidy to capital, even if partially measured, are too high to be ignored. They are critical to the policy analysis under discussion.

Overinvoicing and numerous other related practices are not confined to machinery alone. The bulk of overinvoicing is believed to occur as a leakage of foreign exchange (kept in foreign bank accounts), which can be profitably done for raw materials also. Recall that there was a ceiling on private investment till recently, which should rather cause a tendency to understate capital investment. The reported capital stock in CMI data, indeed, supports this suspicion. I would add: Even granting Klaus's point, we still have no way of measuring this informal assistance..

Point 4: Informal sector interest rates

Klaus seems to have it both ways. On the one side, he wants "lack of

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labor discipline" to be included in labor cost without establishing the fact as to whether indiscipline is aided and abetted by Govt policy. On the other side, he argues for the 120% market rate of interest in informal financial markets, which can in fact be shown to be due to a lack of uniform credit policy of the Govt across all producers, to be used as a rational cost level. Too, Klaus has underscored the problem of debt recovery. The recovery problem has, in part, been caused because under Govt pressure Bangladesh's banking sector "lends at lowest interest rates for the highest risk priority sectors" (WB, Report, Dec. 17, 1987, p. iii). Govt has also stated its intent (e.g., June 1987 budget speech) to reimburse banks for losses associated with concessional lending in priority sector. Thus, if "highest risk priority sectors" are (1) given generous loans and (2) are charged subsidized rates of interest, why do high risk small enterprises, which too have been assigned top priority in the Third 5YP, not get the same treatment? Here objective numerical data are available for both the benchmark rate and the market rate, whereas in the case of "labor indiscipline" even qualitative information is lacking.

Why a time-series of ERAs is so valuable for present analysis?

It is also relevant to state, in the context of Klaus's comment, that a time-series of effective rates of overall assistance (not merely protection of domestic suppliers from foreign competition, but also protection of one domestic sector or group from another through any and all foreign-trade and domestic policies) is being developed not for its own sake. That is not to say that these estimates per se are not very useful. They are, indeed. Otherwise, the TIP Project would probably not have stopped at these calculations and might have gone on further to verify the effects of the calculated ERAs on investment, exports, employment, and other variables. It is rather to say that

for our major purpose, the estimates of EPA develop an intermediate variable: a time-series of policy incidences to be further used to estimate its effects upon various performance variables. Some of the latter variables also have to be developed, e.g., a co-terminous product-wise and industry-wise time-series of total-factor and other productivities. The TIP Project's single cross-section of ERPs is hardly germane to the indicated analysis of the impact of policies.

Gian

April 26, 1988

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REJOINER TO MR. LORCH'S COMMENTS

A. Rab
13 April, 1988

Thanks for Mr. Lorch's comments. These seem to strike a general note which I consider to be more than a devil's due. The comment, "his paper in fact boils down to ERPs for a dozen products in one single year the old TIP data" and hence the implied suggestion that it has been pointless price of work is not probably fair. Professor Sahota can better answer this criticism as conceiver of the idea. I can add that it was not in fact completely TIP data-based: we did use PIDS data for estimating assistance to the handloom products and more recent-year BTMC data on mill-made yarn and fabrics. Mr. Lorch has failed to appreciate the point that using more up-to-date non-TIP data involves more resources which probably were not worth the effort considering the results to be expected. Second, the paper's historical series of estimated statutory assistance cannot be brushed aside as completely meaningless even though largely irrelevant as indicators of actual assistance received by these activities except, note the important qualification, in the case of export garments. Third, the paper's estimates of other assistance measures alongwith conventional EPPs do provide some additional illumination. True, I have not more elaborately discussed the results. But that is precisely because as the paper title indicates we intended it to be a short one.

Indeed Mr. Lorch's first point is not fully clear to me. The paper simply makes the point that there is a lot of "water" in the statutory assistance for the textile products for sale in the domestic market. Hence, the rationale for looking at the actual or observed assistance. Mr. Lorch laments that the paper gives these estimates for only one year! Could he realistically expect to give us estimates for more years? I frankly could not understand this part of his criticism.

For estimating assistance to capital, we have included what could be realistically conceived to be the measurable variables. One need not preclude from consideration any variable presupposing it to be negligible. In fact, we have found the assistance on account of income tax rebate as a significant one. It has turned out to be about 1.5% of the unassisted value of output (i.e., of output value in border price terms). The assistance on account of tax concession for imported machinery is of course found to be very little in annualized terms. We have not taken account of the debt collection problem. There are both conceptual and measurement problems in including such a variable in the ERP analysis. I do not know if anybody has ever included this variable or suggested that one should include it. There are conceptual problems: (a) We are basically concerned with policy variables which are amenable to manipulation. Debt collection is not a variable of this nature. (b) The future may not behave in the same way as in the past with respect to this problem. (c) Such a problem is more likely to be associated in a more punctuated manner in such activities which are relatively more uneconomic. The standard assistance measures usually show high ERPs for such activities even without such debt assistance! There is also the formidable measurement problem. Mr. Lorch could perhaps enlighten us

how we can go about this problem.

Mr. Lorch's third major point about the labour problem is also not quite clear. He points out that labour is not really cheap because of the labour problem. So what? We have taken account of the fact that labour gets more than what it should get in border price terms. Labour gets even more in non-money terms and in money terms which are not always included in wages. Again, we will be helped if Mr. Lorch could guide us how to capture these "payments" to labour.

About the other, comparatively minor points.

- The private mills' data were not used as these were not readily available. The project did not want to use resources on field collection of data. The picture revealed by BTMC data seemed, to be sufficient for our purposes.
- The overvaluation of equipment purchases should not be reckoned as real problem since it can be assumed to have a uniform bias, for all products.
- High interest paid by handweavers is definitely a negative assistance if we accept the official general interest rate of 16% as the norm for the economy. Mr. Lorch should suggest his norm if he finds fault with it.

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