GENERAL AGREEMENT ON

TARIFFS AND TRADE

RESTRICTED

BOP/W/134
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Limited Distribution

Committee on Balance-of-Payments Restrictions

# 1990 CONSULTATION WITH BANGLADESH (SIMPLIFIED PROCEDURES)

## Background Paper by the Secretariat

1. This paper has been prepared in accordance with paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205) to assist the Committee in taken the decision referred to in paragraph 8 of that Declaration. It updates the paper prepared for the 1988 consultation (BOP/W/116).

## I. Previous Consultations with Bangladesh

2. Bangladesh has held eight simplified consultations in the Committee (1973, 1976, 1978, 1980, 1982, 1984, 1986 and 1988). No full consultations have been held.

## II. Recent Changes in Trade Policy

3. As described in the background paper by the Secretariat for the 1988 consultation, all imports with the exemption of food grains (which are under the control of the Ministry of Food), fertilizers and items financed by project aid are guided by an annual import policy. The annual import policy (IPO) is issued by the Chief Controller of Imports and Exports of the Ministry of Commerce.

4. The Import Policy Order (IPO) for the fiscal year 1988/89 (July-June) was based on two lists of products, the negative list and the restricted list, described according to the Harmonized System of Nomenclature and the Import Trade Control (ITC) schedule. The negative list is composed of banned imports and the restricted list of products whose importation is permitted only if certain conditions, relating mainly to the nature of end-users and to quality standards are met.

5. The negative list for 1988/89 included items in 189 out of a total of 1012 product categories at the ITC four-digit level. Importation of these goods is banned either for social or religious reasons, or because similar items are locally produced. The restricted list for 1988/89 included items in 153 product categories. Essential inputs for the local industry and some consumer goods were removed from the 1987/88 negative and restricted

lists[1]. In addition, there are special negative lists for the jute and textile mills.

6. Under the Import Policy Order for the fiscal years 1989/90 and 1990/91, the negative and restricted lists were merged into one controlled list which contains 354 categories. The special negative list for the jute and textile mills was eliminated.

7. Items not included in the negative list or the restricted list were freely importable when financed from the Secondary Exchange Market (SEM) provided that the importer had a valid import registration certificate. Letter of Credit Authorization forms, which are issued by authorized dealer banks, are required for all imports with the exception of imports by government departments, but a separate import licence is not required.

8. Until June 1988, the Bangladesh Bank imposed a minimum foreign exchange margin requirement for the opening of letters of credit in the SEM. This was 50 per cent for raw materials and 100 per cent for commercial imports. In the official market[2], minimum margin requirement in domestic currency was 5-15 per cent for industrial imports and 25-35 per cent for nonessential commercial imports.

9. In July 1988, these minimum margin requirements were abolished. The advance foreign exchange deposits for the establishment of letters of credit in the SEM were to be arranged only on a banker-customer relationship basis.

10. In mid-February 1990, a 100 per cent advance deposit requirement for issuance of letters of credit for commercial imports under the SEM was again introduced. In late-February, this margin was reduced to 50 per cent and a similar margin for industrial imports was introduced. In March 1990, the latter margin was reduced to 25 per cent.

11. Bangladesh maintains a flexible exchange rate policy, under which the value of the Taka is pegged to a weighted currency basket of the country's six major trading partners. Different exchange rates arise from the operation of the official exchange market and the Secondary Exchange Market (SEM).

12. The Secondary Exchange Market (SEM) comprises the Wage Earners' Scheme (WES) and the Export Performance Benefit Scheme (XPB). Under the WES, foreign exchange earnings remitted by workers abroad, tourist receipts and most service receipts are sold at a rate determined by a committee of authorized foreign exchange dealers constituted by the Bangladesh Bank.

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[1]For the fiscal year 1987/88, the negative list included 280 items and the restricted list 239 items.

[2]Imports at the official exchange rate are subject to allocation on the basis of foreign exchange availability.

Under the XPB scheme, exporters (except those of raw jute and unprocessed leather) are eligible to receive an exchange rate premium (the XPB) which is set to equal the difference between the WES rate and the official rate. XPB entitlements were withdrawn for exporters of jute goods and certain non-traditional export items including frozen fish, crust and finished leather, and a small range of ready-made garments that were eligible for export cash subsidies in 1989/90.

13. Each eligible item receives a coefficient of 40, 70 or 100 per cent of the XPB, depending on that item's domestic value added and the priority that the Government places on encouraging its export. At the end of 1988, 76 items with value added greater than or equal to 70 per cent were eligible for 100 per cent XPB (compared with 72 in 1987). Export products with a value-added of between 50 per cent and 69 per cent were given a coefficient of 70 per cent. Exports of garments were eligible for 70 per cent of the XPB if they were made from imported raw materials, and 100 per cent if domestic materials were used. In case of leather items, depending on the use of imported or domestic raw materials, the coefficients were 40 per cent and 100 per cent, respectively. All other non-traditional exports received a 40 per cent of the XPB. At the end of 1989, 70 items were eligible for 100 per cent of XPB.[3]

14. Under the export policy for the fiscal years 1989/90 and 1990/91, special export incentives were introduced. They include concessional interest rates on credit and lower duty rates on imported materials. These incentives are available for priority export sectors such as toys, luggage and fashion goods, and electronic and leather products. An export cash subsidy scheme for 15-20 per cent of the value of jute goods exports was also introduced. In February 1990, export cash subsidies of 5-20 per cent were made available for exports of frozen fish, crusts and finished leather, and a small range of ready-made garments. These rates were reduced in March 1990.

15. Since September 1989, joint ventures located in Export Processing Zones are allowed to retain 70 per cent (75 per cent for the garment industry) of their export earnings in foreign currency and convert the remaining 30 per cent at the SEM rate.

16. The premium in the SEM over the official exchange rate was reduced from around 5 per cent at end-1987 to 2 per cent in November 1988. Since then, it remained stable at around 2 per cent, a level which the Government

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[3]Light engineering products, machinery tools and equipment, cast iron products, household electrical appliances, and electrical cables with a value added of 60 per cent and above, between 40 per cent and 59 per cent, and less than 40 per cent were given coefficients of 100 per cent, 70 per cent, and 60 per cent, respectively.

considers necessary to encourage exports and workers' remittances from abroad through the secondary market.

17. In January 1990, the official exchange rate was at Taka 32.27 per US dollar and the Secondary Exchange Market rate at Taka 32.92 per US dollar. Effective March 5, 1990, April 9, 1990 and May 20, 1990 both the official rate and the SEM rate were depreciated by 5 per cent, 1 per cent and 2 per cent in Tata terms, respectively. After the May depreciation, the official and the SEM rates stood at Taka 34.90 per US dollar and Taka 35.605 per US dollar, respectively.

## III. Economic and trade developments

### Overview

18. In the years 1987 to 1989, a series of natural disasters played a major rôle in reducing growth in the Bangladesh economy. In fiscal year 1987/88, strikes also affected industrial activity. Real GDP growth slowed to 2.7 cent, while inflation increased to more than 11 per cent, primarily due to supply shortages. A significant reduction in development expenditure was mainly responsible for a reduction of the budget deficit of 0.7 per cent of GDP, to 7.7 per cent of GDP. In 1987/88, the current account deficit increased slightly to 5.8 per cent of GDP despite a rise in exports and workers' remittances.

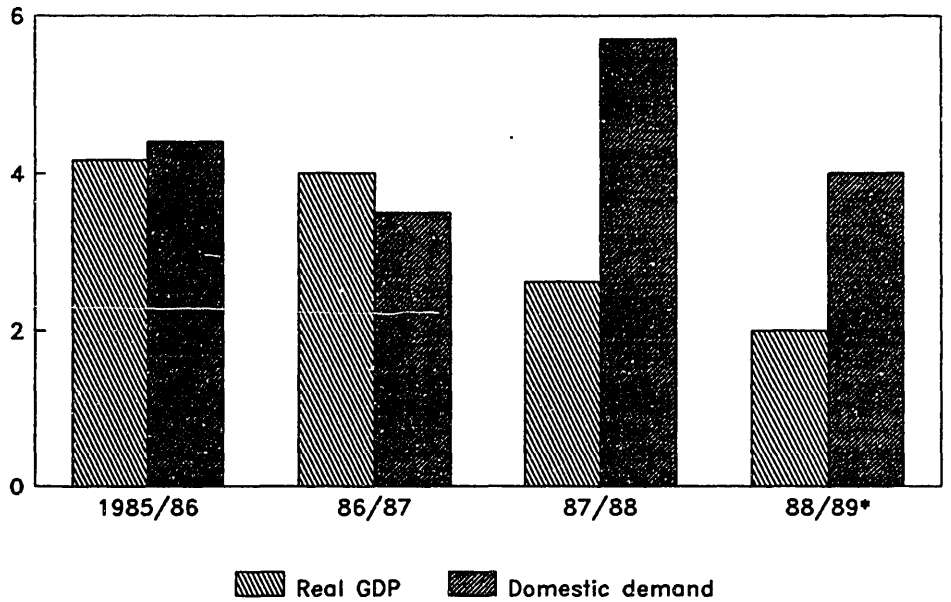
19. In 1988/89 real GDP growth again declined, to 2.4 per cent. Inflation fell to 8 per cent. As development spending was again reduced (largely due to a lack of local counterpart funds), the budget deficit fell further to an estimated 7.2 per cent of GDP. The current account deficit widened to 7 per cent of GDP despite sustained growth in non-traditional exports. The growth in workers' remittances slowed because of weak demand in the Middle East labor market and additional imports of food and equipment were necessitated by shortages that resulted from the floods.

20. This fiscal year 1989/90, a good harvest should increase economic growth to 5-6 per cent. However, it is expected that the fiscal revenue target will not be met and the development programme will have to be cut once more. Exports were more than 11 per cent higher in the first seven months of this fiscal year than in the same period of 1988/89. However, imports grew more than 43 per cent in the same period largely as a result of financial policy developments. For the year 1989/90, exports and imports are expected to increase by 17 per cent and 6 per cent respectively. The increase in non-aid imports is expected to result in a decline of gross official reserves from a level equivalent to 3.4 months of imports in 1988/89 to less than 2 months of imports at the end of 1989/90. As a result of measures implemented since Febrary 1990 to curb domestic credit and contain budgetary expenditure, the current account deficit is expected to be contained at 6.5 per cent of GDP in 1989/90 and gross official reserves to have stabilized.

Aggregate supply and demand

21. In 1987/88, real GDP growth slowed to 2.7 per cent due to the effects of floods on agricultural output and strikes in the industrial sector (Graph 1). Gross fixed investment represented about 12 per cent of GDP in 1987/88, reflecting a continued modest success in public resource mobilisation, diversion of government resources to current expenditure and low domestic private savings. Private investment was reduced by strikes and political disturbances. In 1987/88, national savings were about 6 per cent of GDP, with domestic savings accounting for slightly less than half of the total.

Graph 1 – Real GDP and domestic demand
(Annual percentage change)




*Estimates
Source: IMF.

22. Real GDP growth is estimated to have fallen again to 2.4 per cent in 1988/89, largely as a result ot further devastating natural disasters. Thanks to timely implementation of relief programmes by the authorities and policies designed to improve the availability of resources, agriculture performed better than expected. Foodgrain production remained stable at the record levels of 1986/87, reacting to higher prices and government measures to reduce the domestic prices of some farm inputs, increase the use of fertilizers and facilitate credit. The availability of irrigation equipment was improved through the simplification of sales procedures, import duty exemptions and price reductions.

23. In 1988/89, gross fixed investment is estimated to have fallen to 11 per cent of GDP, mainly due to problems in implementing public sector projects. Public savings remained negative as a result of continued revenue shortfalls, additional expenditures linked to flood-relief operations and rapid increase in other current expenditure. While workers' remittances remained strong, private domestic savings were low due to the overall weakness of the economy and expenditures to repair damaged property.

24. Most of the estimated growth of 5-6 per cent in real GDP in the current fiscal year is accounted for by an excellent grain harvest of nearly 19 million tonnes. Industry has remained depressed by low investment and overcapacity, despite reductions in regulations affecting the importation of inputs and private investment procedures.

25. As a result of a medium-term policy of denationalisation of industry, public sector ownership of industrial assets fell from 85 per cent in 1982 to 40 per cent in 1988. However, the public sector still accounts for the majority of large-scale industries, such as jute goods, textiles, fertilizers, cement, and newsprint.

26. Investment procedures were simplified in 1986; self-financed projects no longer required official approval, and the levels of investment which could be approved by banks without official permission were increased. A new Board of Investment, established in January 1989, has replaced a number of regulatory agencies previously in existence. Private sector investment has concentrated in the production of ready-made garments. This has been the fastest growing sector in exports of nontraditional goods, which have recently surpassed jute in export value. The garments sector, together with fertilizers and construction materials, were the main contributors to the steady 4 per cent growth of industrial production in the period 1987/88-1988/89. Many other industries were adversely affected by shortages of imported inputs resulting from changes in import priorities because of the floods, strikes (in 1987/88) and weak domestic demand.

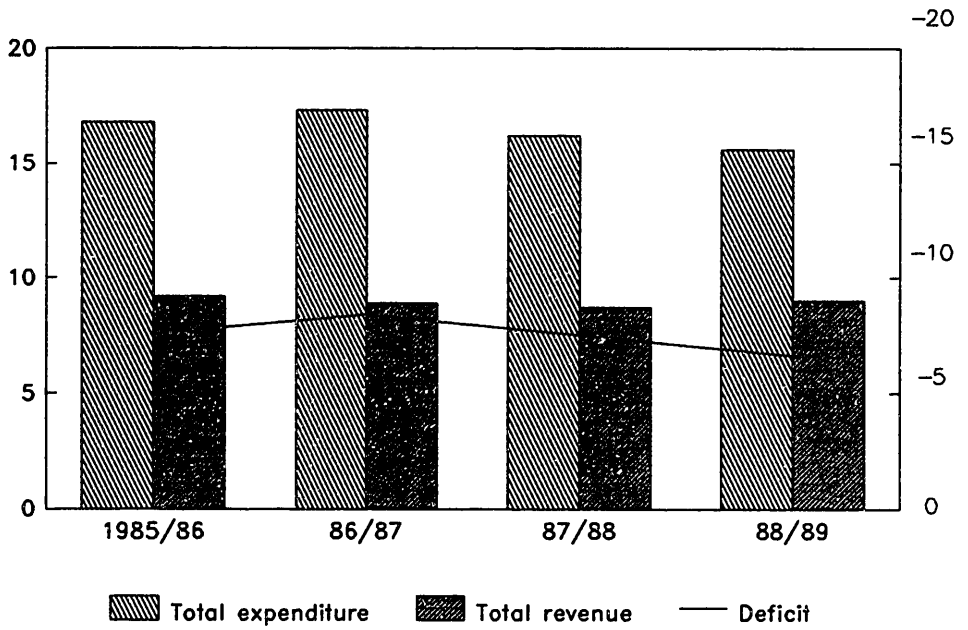
Public finances

27. The consolidated central government budget comprises the current budget, the Food Account, the Annual Development Programme (ADP) and certain special spending and lending operations. Central government revenue represents a relatively small share of GDP - about 9 per cent in

the period 1983/84-1988/89 - due to the narrowness of the tax base. There is a heavy reliance on customs duties. Government expenditure, although small relative to other low-income countries, has averaged almost 17 per cent of GDP in the same period. One worrying development is the reduction of the share of the ADP in GDP, from more than 8.5 per cent of GDP in 1983/84 to 6 per cent in 1988/89.

28. Most of Bangladesh's budget deficit has been traditionally financed by concessional foreign funds. Domestic banks' share of the deficit has been equivalent to less than 1 per cent of GDP. (Graph 2) In 1987/88, the overall deficit declined by 0.7 percentage point to 7.7 per cent of GDP. This partly reflected a sharp decline in ADP expenditures, following the completion of large projects. At the same time, a shortage of domestic counterpart funds also led to under-utilisation of project aid. These developments more than offset the rise in current government expenditures. Revenue increased only marginally, despite government measures to mobilise resources other than tariffs and to reduce the share of tariff revenue in government revenue.

Graph 2 – Central government budget deficit
(Percentage of GDP)




Source: IMF.

29. In 1988/89, the overall deficit declined further to 7 per cent. Revenue as a share of GDP increased slightly. The shift away from taxes on international trade continued, but tax collection difficulties and slower economic activity caused a shortfall in revenues. Current expenditure rose as a result of the larger outlays required for relief after the floods. Development spending was again constrained by implementation difficulties and shortages of local counterpart funds.

30. The 1989/90 budget projected a 35 per cent increase in revenue; with the budgeted increase in current expenditure (including the food account deficit) held to 20 per cent, development spending was expected to rise by 37 per cent. Despite corrective measures in mid-year to offset early shortfalls in tax collections, revenue is estimated to fall short of the budget target. While current spending is being constrained close to the original budget allocation, the food account deficit will be larger than anticipated. With the shortage of local counterpart taka resources, development spending is estimated to increase by only 5 per cent. For the year 1989/90, the budget deficit will remain close to 7 per cent of GDP.

Money and credit

31. The Bangladesh financial system comprises the Bangladesh Bank (the central bank), deposit money banks (with 4 nationalised banks holding 70 per cent of total deposits) and non-bank financial institutions. The government is heavily involved in monetary policy formulation, while the central bank carries out monetary and financial management. Interest rates are administered, with the exception of those paid on a few certificates of deposit schemes and the interbank rate, and have not been adjusted frequently. Thus, in particular, lending rates have not reflected the cost of funds, maturities and relative risks.[4]

32. Aware of these problems, the authorities have recently initiated financial sector reforms. Under these, monetary policy relies less on the use of ceilings on bank credit and more on the use of minimum cash reserve or liquid asset requirementss as instruments of monetary control; the interest rate structure is to become more flexible and more closely orientated to the market; and the Bangladesh Bank's rôle in monetary policy and bank supervision is to be strengthened.

33. In 1987/88, broad money increased more than 18 per cent as a result of growth in external reserves and strong domestic credit expansion resulting from exceptional needs following the floods. In October 1987, the Bangladesh Bank increased deposit money banks' liquid asset requirement to

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[4]In November 1989, a new system for interest rate determination was established under which banks are allowed to set their own deposit and lending rates within certain bands established by the Bangladesh Bank. Effective January 1, 1990, the Bangladesh Bank's re-finance facility for priority lending was largely replaced by a single rediscount window.

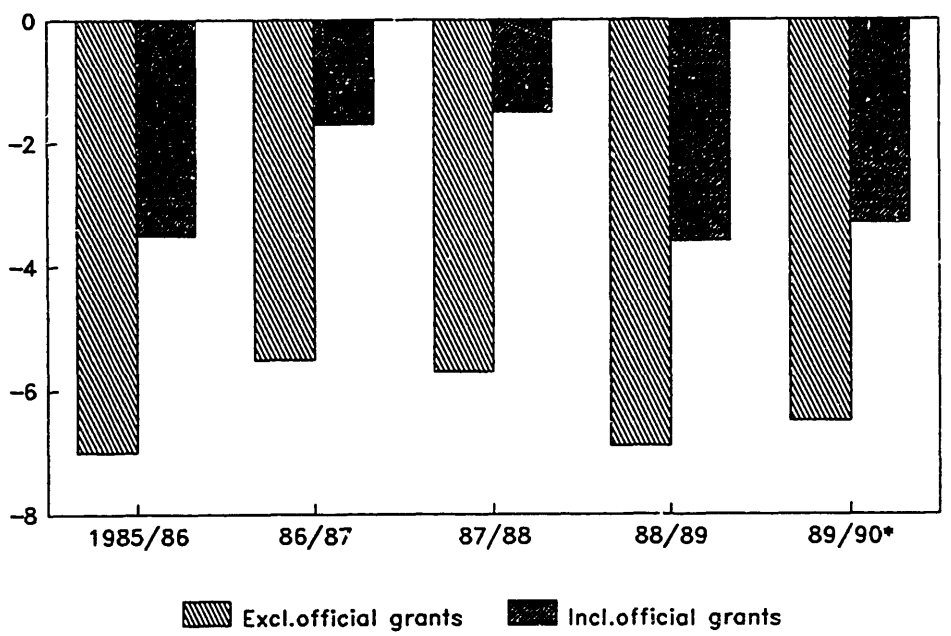
reduce excess liquidity. However, following the floods and cyclone of the following year, broad money growth was almost 16 per cent, with private sector credit demand remaining strong, while the public sector credit growth was below target.

34. In the first half of 1989/90, the growth of credit to the central administration and to non-financial public enterprises accelerated. This resulted from government procurement expenses for stockpiling purposes following the record harvest, developments in export cash subsidies and increase in wages and salaries.

Balance of payments

35. The natural disasters of 1987/88 and 1988/89 had a relatively small overall impact on the balance of payments (Table 1). Although the floods affected traditional exports, increased workers' remittances, the strength of non-traditional exports, and modest import growth due to depressed domestic demand helped to diminish their effects on the current account. In 1987/88, the deficit on current account grew slightly to 5.7 per cent of GDP (Graph 3) and to an estimated 6 per cent in 1988/89. The deficit in the current account is projected at 6.5 per cent of GDP in 1989/90, reflecting both the increase in the fiscal deficit and rapid growth in domestic credit. Aid disbursements, which recorded high levels in 1987/88 and 1988/89 mainly as a result of increased emergency food and commodity aid relating to the floods as well as large amounts of project aid for certain large scale projects, are expected to decline in 1989/90. Gross reserves, which were maintained at about 3.5 monts of imports in both 1987/88 and 1988/89, are estimated to fall to the equivalent of less than two months of imports in 1989/90, reflecting mainly the increase of non-aid imports (Graph 4).

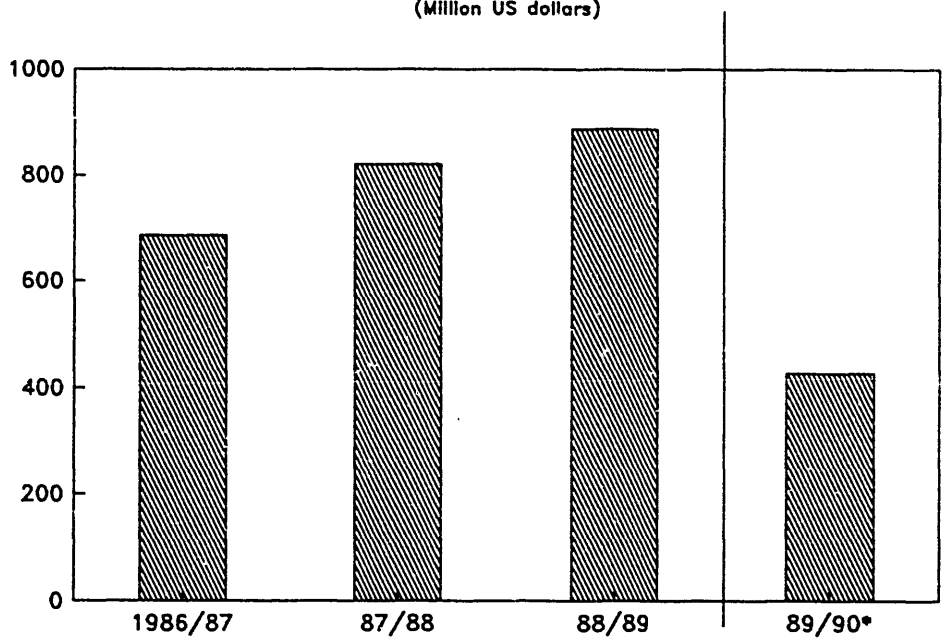
Graph 3 – Current account balance
(Percentage of GDP)




*Estimates.

Source: IMF.

Graph 4 – International reserves, excluding gold
(Million US dollars)

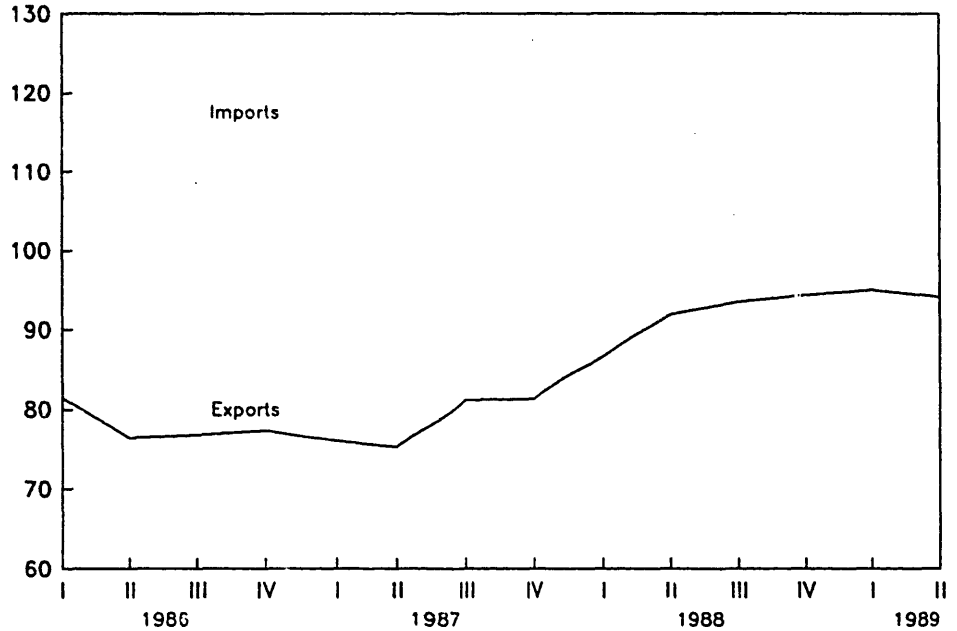



*March
Source: IMF, IFS.

## The merchandise trade balance

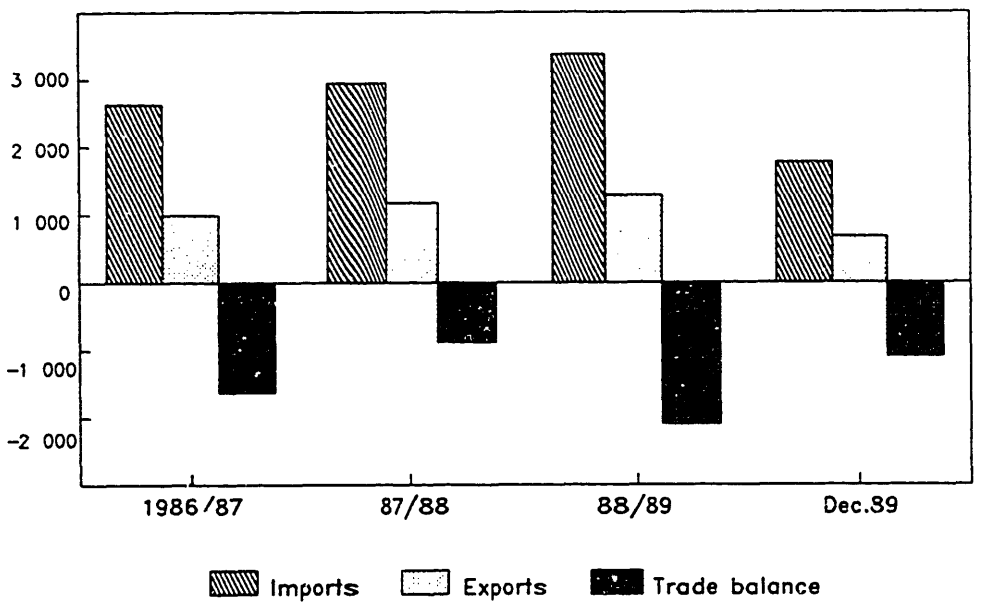
36. The adverse impact of the floods on the production of traditional exports was mitigated by the rapid recovery of non-traditional exports, in particular, ready-made garments exports (Table 2). Beginning in mid-1987, Bangladesh enjoyed a steady rise in the unit value of its exports which lasted until the second quarter of 1989 (Graph 5). On a customs basis, merchandise exports totalled $1.2 billion in 1987/88 and $1.3 billion in 1988/89 (Graph 6). In the current fiscal year, total exports are expected to reach $1.5 billion.

Graph 5 - Unit value of merchandise exports and imports
(Index 1985=100; quarterly)




Source: IMF, IFS.

Graph 6 - Value of merchandise trade*
(Million of US dollars)




*On a customs basis.
Source: IMF, IFS

37. In 1987/88, the rise in imports resulted mainly from growth in foodgrain imports. Non-food imports rose moderately, while capital imports declined by 15 per cent due to weak domestic demand conditions and sluggish investment. In 1988/89, the volume of imports continued to increase strongly reflecting import liberalization and the recovery of economic activity after the floods. The customs value of merchandise imports totalled $3.0 billion in 1987/88 and $3.4 billion in 1988/89, respectively. The increase in the value of imports in 1989/90 is estimated at 6 per cent, notwithstanding the large increase in non-aid imports in the first eight months of the fiscal year. The growth in raw materials and intermediate goods is estimated at 25 per cent, part of which represented higher inputs for the export-oriented garments industry. However, capital goods are estimated to increase by 8 per cent and foodgrain imports are estimated to decline by 4 per cent.

The capital account and international indebtness

38. Foreign aid disbursements increased by 3 per cent and 2 per cent in 1987/88 and 1988/89, respectively, but then declined by an estimated 4 per cent in the current fiscal year. Both food aid and commodity aid were largely utilised, while project aid was limited by implementation problems and lack of domestic funds. Other short- and medium-term loans showed a deficit largely due to trade-financing items.

39. The total outstanding external debt rose by 14 per cent in 1987/88, and by an estimated 4 per cent in 1988/89. Part of the increase is due to the revaluation of the debt stock that resulted from the appreciation of the Japanese yen and the SDR. This phenomenon has been reversed during the current fiscal year. Bangladesh benefits from concessional terms on about 90 per cent of its total external debt. In 1987/88 and 1988/89, the debt service ratio declined to about 23 per cent and 21 per cent, respectively of current receipts (partly as a result of a decrease in food credit repayments).

**Table 1 - Balance of payments, 1986/87-1989/90**
(Million US dollars)

| | 1986/87 | 1987/88 | 1988/89 | 1989/90* |
|---|---|---|---|---|
| Trade balance | -1 546 | -1 756 | -2 089 | -2 083 |
| - Exports (f.o.b.) | 1 074 | 1 231 | 1 286 | 1 500 |
| - Imports (c.i.f.) | -2 620 | -2 987 | -3 375 | -3 583 |
| Services, net | -151 | -144 | -149 | -194 |
| Private transfers | 731 | 788 | 836 | 800 |
| of which: Workers' remittances | 696 | 737 | 771 | 780 |
| Current account balance[1] | -966 | -1 112 | -1 402 | -1 477 |
| Capital account, net | 1 103 | 1 251 | 1 397 | 1 314 |
| Aid disbursements[2] | 1 595 | 1 640 | 1 669 | 1 600 |
| MLT amortization payments | -154 | -166 | -191 | -212 |
| Short- and medium-term loans (net) | -275 | -192 | -25 | -84 |
| Foreign direct investment (net) | 2 | 3 | 2 | 9 |
| Errors and omissions (net)[3] | -65 | -34 | -57 | ... |
| OVERALL BALANCE | 137 | 139 | -5 | -162 |
| Memorandum item: | | | | |
| Gross reserves[4] | 752 | 896 | 963 | 560 |
| (In months of imports) | 3.4 | 3.6 | 3.4 | 1.9 |

... Not available
*Estimates.
1Excluding official grants.
2Including official grants.
3Includes counterpart valuation changes.
4Includes Asian Clearing Union account and foreign exchange from nonresident foreign currency deposits.

Source: IMF.

**Table 2 - Principal merchandise exports, 1986/87-1989/90**
(Percentage shares)

| | 1986/87 | 1987/88 | 1988/89 | 1989/90* |
|---|---|---|---|---|
| Ready-made garments | 27.8 | 35.3 | 36.6 | 41.7 |
| Jute goods | 28 | 24.5 | 21.8 | 20.5 |
| Frozen shrimps and frog legs | 12.6 | 11.3 | 11.0 | 10.1 |
| Leather and leather products | 12.6 | 12 | 10.7 | 9.5 |
| Raw jute | 10 | 6.5 | 7.5 | 8.7 |
| Tea | 2.7 | 3.2 | 3.1 | 3.5 |
| Naphtha and furnace oil | 1.2 | 0.9 | 1.2 | 0.9 |
| Other | 5.2 | 6.3 | 8.1 | 5.1 |
| Total | 100 | 100 | 100 | 100 |

* Estimates

Source: IMF.

**Table 3 - Principal merchandise imports, 1986/87-1989/90**
(Percentage shares)

| | 1986/87 | 1987/88 | 1988/89 | 1989/90* |
|---|---|---|---|---|
| Capital goods | 38.3 | 28.6 | 30.3 | 30.8 |
| Foodgrains[1] | 10.4 | 16.4 | 11.1 | 10.0 |
| of which: | | | | |
| Wheat | 8.5 | 11.3 | 10.6 | 7.9 |
| Rice | 1.9 | 5.0 | 0.5 | 2.1 |
| Textiles | 8.5 | 10.9 | 10.5 | 13.1 |
| Edible oil | 4.4 | 4.6 | 5.0 | 4.5 |
| Crude petroleum | 4.8 | 4.6 | 3.8 | 3.2 |
| Petroleum products | 4.0 | 4.6 | 4.5 | 4.8 |
| Cotton[1] | 1.7 | 2.7 | 2.8 | 2.8 |
| Other | 27.9 | 27.6 | 32.0 | 30.8 |
| Total | 100 | 100 | 100 | 100 |

* Estimates
[1]Nondutiable; crude petroleum imports were made subject to duty in 1986/87.

Source: IMF.