Competitiveness and future challenges of bangladesh economics essay

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Financial development and international trade, developed from empirical growth literature, are identified as macroeconomic variables highly correlated with economic growth. This study employs the co-integration and Granger causality tests to investigate long-run relationship and the direction of causality between financial development, international trade and real income growth in Bangladesh. The estimation procedure also passes a battery of diagnostic tests indicating stability of the long run and short run estimates. The results of the study do not reveal any long-run relationship between economic growth and financial development as scaled by money supply and domestic credits, and between exports and economic growth. On the other hand, Granger causality test results suggest that the exported growth hypothesis can be inferred for Bangladesh economy in the short run. However, both export and import growth cause changes in the money supply in the short run. The nexus is unidirectional. Long run GDP growth has an effect on income growth in the short run. Finally, this study has shown that import growth causes a change in the domestic credit in the short run. The findings of this paper have important implications for macroeconomic policies of the nation. Financial development and international trade are identified as macroeconomic variables as being highly correlated with economic growth performance across countries in the empirical growth literature (Beck, 2002). There are also empirical studies in the literature searching the channels through which both financial development and trade openness affect economic growth. Kletzer and Bardhan (1987) incorporate financial sector into the Heckscher-Online trade model and show that financial sector development gives countries a comparative advantage in industries that rely more on external financing. The relationship between financial development and economic growth has now well recognized in the literature that financial development is crucial for economic growth(Calderon and Liu, 2003) as it is a necessary condition for achieving a high rate of economic growth (Chang, 2002) and has a strong positive relationship with economic growth (Mazur and Alexander, 2001). On the other hand, financial development significantly reduces economic growth for countries in Latin America experiencing relatively high inflation rates (De Gregorio and Guidotti 1995). Patrick (1966) developed two hypotheses testing the possible directions of causality between financial development and economic growth, that is, the supply-leading hypothesis, where it posits a causal relationship from financial development to economic growth, and the demand-following hypothesis, where it postulates a causal relationship from economic growth to financial development. In the empirical literature, McKinnon (1973), King and Levine (1993), Neusser and Kugler (1998) and Levine et al. (2000) support the supply-

leading hypothesis while Gurley and Shaw (1967), Goldsmith (1969), and Jung (1986) support the demand-following hypothesis. Yildirim, Ã-cal and Erdogan (2008) reconfirm the ‘ supply leading’ hypothesis for Turkey taking geographic components and spatial dimension into account. Vuranok (2009) supports the positive

association between financial development and economic growth rate in Turkey in the short run. In the context of Asian countries, Sinha (1999) claims along the same line for Japan, Malaysia, Philippines and Sri Lanka whereas for (South) Korea, Myanmar, Pakistan and Thailand, furthermore, he asserts that export instability and economic growth are directly related. He also postulates that in most cases economic growth is positively associated with domestic investment while the findings are mixed for India.

Literature Review:

Bangladesh's steady growth for the past two decades and the average annual GDP growth more than 6 percent over the last five years and drop of almost 10 percent in the poverty rate – are both very respectable. The past decade's boom in exports – particularly the apparel sector is very significant to country's economic growth. This report gauges Bangladesh's trade competitiveness and future challenges. This report uses the Prof. Michael Porter's data base of Harvard Business School for cluster map and bubble for competitiveness analysis, the world trade Indicator (WDI) database, International Trade Centre (ITC)'s trade map and competitiveness and World Economic Forum (WEF) website for data and graphical presentation for competitiveness analysis. To make the most of its export opportunities on the changing international playing field, Bangladesh needs to follow a strategic game plan, invest in infrastructure, technology and skills, streamline policies, and improve quality and safety standards.

Trade Competitiveness: Essential Issue:

The determinants of competitiveness are many and complex. For hundreds of years, economists have tried to understand what determines the wealth of nations. This attempt has ranged from Adam Smith's focus on specialization and the division of labor to neoclassical economists' emphasis on investment in physical capital and infrastructure, and, more recently, to interest in other mechanisms such as education and training, technological progress, macroeconomic stability, good governance, the rule of law, transparent and well-functioning institutions, firm sophistication, demand conditions, market size, and many others.(The Global competitiveness report 2008). The World Economic Forum calculated the Global Competitiveness Index (GCI) for measuring national competitiveness, which captures the microeconomic and macroeconomic foundations of national competitiveness. The Global Economic

Forum (GEF) defines competitiveness as the set of institutions, policies, and factors that determine the level of productivity of a country. The level of productivity, in turn, sets the sustainable level of prosperity that can be earned by an economy. The GEF group all these components into 12 pillars of economic competitiveness. These are as Institutions, Infrastructure, Macroeconomic stability, Health and primary education, Higher education and training, Goods market efficiency, Labor market efficiency, Financial market

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sophistication, Technological readiness, Market size, Business sophistication, and Innovation. At micro level, a firm is said to be competitive if it is profitable and maintains or gains market share in a world of fair and free markets with intense domestic and international competition. The IMF defines the competitiveness as an appropriate level of competitiveness in the short run is typically associated with the value of the real exchange rate, which, in conjunction with other domestic policies ensures both internal and external balance. In the long run competitiveness is more generally defined in terms of an economy's ability to support increases in living standards. According to the OECD countries, the degree to which a country can, under free trade and free market conditions, produce goods and services which meet the test of international markets, while simultaneously maintaining and expanding the real incomes of its people over the long term. The European Commission defines competitiveness as the ability of an economy to provide its people with high and rising standards of living and high rates of employment on a sustainable basis.

The Drivers of Competitiveness:

Productivity, which measures efficiency of resources used to produce goods and services, is the long-term driver of competitiveness. Only growth in productivity will allow firms to compete internationally and maintain and improve real income. The new investments in education and skills, machinery and equipment, physical and technological infrastructure and innovation (including commercialization) will all contribute to improvements in productivity, competitiveness and prosperity. A sound macroeconomic, political, legal, and social context creates the potential for competitiveness, but is not sufficient. Movements in exchange rates also will impact the cost structure and relative output price in the short to medium-term. According to Michael Porter there are three Stages of Competitive Development, Factor driven economy that is macro economy, political, and legal stability with efficient basic three infrastructure and lowering the regulatory costs of doing business. The investment driven economy should be local competition, market openness and incentives and rules encouraging productivity as well as cluster development and then finally Innovation driven economy would be with advanced skills, advanced infrastructure, incentives and rules encouraging innovation and cluster upgrading.

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Bangladesh Trade Overview:

Bangladesh economic growth over the last half decade is more than 6 percentages and fastest real trade growth country rank 13th out of 152 countries (WTI 2008) is emerging economy in South Asia. The real export growth is more than 9 percent higher than all other south Asian countries except India (WTI 2008). Bangladesh export share to GDP was 10 percent in 2004 which was the lower than India, Pakistan, Sri Lanka, even Cambodia just higher than some least developed Countries in Africa. The export share to GDP has been increasing over the year but not very significant. The export share to GDP in 2007 is 17 percent (Export Promotion Bureau 2008). However, Bangladesh launched comprehensive trade reforms in the early 1990s that included substantial reduction of tariffs, removal of quantitative restrictions, and moves from multiple to a unified exchange rate and from a fixed to freely floating

exchange rate system to increase its export performance. Nonetheless, the economy is still saddled with one of the least liberal trade policy regimes in the world, reflected in its rank near the bottom (140th out of 152 countries) on the latest Trade (MFN) Tariff Restrictiveness Index (TTRI) (WTI 2008). The MFN applied simple tariff average of 14. 14 percent in 2007 is lower than its late 1990s average of 21. 8 percent and similar to the regional mean, which however is lower compared to India. The garments export industry is allowed duty free import of raw materials. The maximum tariff rate (inclusive of ad valorem equivalents of specific tariffs) has declined from a high of 300 percent in the late 1990s to just 25 percent in 2007 (WTI 2008). The country has liberalized its banking and telecommunication sectors. Although, Bangladesh did not make any commitment in financial sector under GATS but the rate of liberalization in the financial sector has been quite rapid. This is a sector where Bangladesh has limited export but very crucial for country's economic development. However, the low overall GATS commitment suggests ample room for greater future multilateral commitments to services liberalization.

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GDP Growth Rate of South Asian Countries

GDP Growth Rate (%) of Selected South Asian Countries

GDP Annual Growth rate

Year

Countries

0

2003

Bangladesh

2

2004

India

4

2005

Nepal

6

2006

Pakistan

8

2007

Srilanka

Sources:

1. World Trade Indicators 2008

2. Prof. Michael E. Porter, International Cluster Competitiveness Project,

3. World Development Indicators, 2008

Bangladesh Export Performance:

Bangladesh's export boom for in the 1990s particularly the rapid expansion of the readymade garment (RMG) exports under the umbrella o f the Multi-Fibre Arrangement (MFA) and under the WTO Agreement on Textiles and Clothing (ATC). The RMG sector contributes 10. 5 percent to GDP and more than 78 percent of the country’s export earnings and directly employing around 4. 5 million workers and

most of them are women (UNESCAP 2008). Chart 4 shows Bangladesh export portfolio cluster. The apparel sector is 16 positions in world ranking and Bangladesh number one exporting sector. In the apparel cluster Bangladesh’s men shirts export is world 7th position and hosiery and other garments is 10th position of world export ranking (chart 5). Bangladesh’s share of world export in clothing is 2. 3 percent in 2005 and 4th position in Asia just after China, Hong Kong and India (table 1). Bangladesh also exports hats and it is 14th position of world ranking. The main destination of Bangladesh export is USA, Germany, England, France and Canada, Belgium, Japan, Hong Kong, China and Korea (chart 6). However, Bangladesh has increased considerably trade openness in recent years the ratio of total trade (exports

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plus imports) to GDP has increased from 17. 6 percent in 1990 to around 42. 0 percent in 2007 where Indian ‘ trade openness is 39 percent in 2007 (WTIR2008). It also exports textiles which rank is 43 in the world. Bangladesh also exports significantly in fishing and fishing product and its world ranking 39. Bangladesh leather and leather product exporting rank is 35 in the world.

National Competitiveness Assessment

Bangladesh’s business environment generally compares favorably with other Asian countries and USA, Canada as well as some European countries particularly England, Germany and France. It's rank 108th on the 2008-2009 Global Competitiveness Index

which is very ominous feature for Bangladesh. However, according to the World Bank Ease of Doing Business ranking Bangladesh rank is 107th behind the Pakistan (76), Sri Lanka (101), Vietnam (92), China (83), Malaysia (20) but ahead of India (122), Nepal (111) Cambodia (135), Indonesia (129) and Philippines (140). Among the South Asian Bangladesh position is better than India and Nepal but behind the Pakistan and Sri Lanka (table 3 and chart 8). There are 115 competitiveness indicators of 12 pillars of the World Economic Forum and Bangladesh has only 10 comparative advantage indicators and some of them are presented of the following tables 2. Bangladesh has some advantage in financing through local equity market, Number of procedures required to start Business, Domestic market size, Strength of investor protection, Non-wage labor cost etc. But performance in these areas is also very far behind standard. Bangladesh has significant weakness and most important issue are follows, Quality of port infrastructure, Nature of competitive Advantage, Public trust of politician, Efficiency of legal framework, Burden of customs procedures, Time requires starting business etc. However, Bangladesh labour productivity is higher than Pakistan, Nepal, Cambodia, but lower than India and Vietnam (Michael Porter 2008). As we have seen, GDP growth has been impressive over the decade, and could have been even higher but for policy and institutional weaknesses in important investment ten areas that have been identified as main barriers for economic growth. In addition, the CPI inflation has touched around 10 percent recently, and food price has been concern the number one priority for government agenda. However, Bangladesh’s exposure to external shocks has also been limited, though mainly due to a low trade base. The most binding policy and institutional constraints associated with insufficient global integration, economic governance,

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physical infrastructure, human capital and innovation, lack of access to finance as well. In terms o f openness to FDI, Bangladesh ranks 137 among the 141 countries in the WDI database on gross FDI inflows to GDP ratio during the 1997-2007. The Inward FDI is very low compare to India, China, Pakistan and Vietnam and higher than only Nepal, Iran, Republic of Congo and Samoa (World Bank 2008). This is despite the fact that Bangladesh has a relatively liberal FDI regime. Clearly, foreign investors are deterred by the licensing requirements for private activity in the energy and the telecom sectors, as well as other investment climate problems. The perception of widespread corruption is also likely to have dampened FDI inflows, as has been shown for other countries as well.

Time & Documentary Requirement for Export and Import in South

Asia

05

10

15

20

25

30

35

Bangladesh

Bhutan

India

Maldives

Nepal

Pakistan

Sri Lanka

Number of Documents

Time for export (days) Time for import (days)

Documents for export (number) Documents for import (number)

Source: Ease of Doing Database (2009)

The Most Problematic Factors for Doing Business in Bangladesh

Source: The Global Competitiveness Report 2008-2009 (WEF)

Challenging Issues for Bangladesh

The past decade's boom in exports -particularly the apparel sector is very significant to country's economic growth, but the recent GDP growth has not led to significant improvements in the living standards of most people and the social factors are still challenging. Despite impressive economic growth and some reforms over the two decades Bangladesh's business environment is still challenging. The key issues are:

â-Š Poor quality infrastructure particularly road networks and electricity supply

â-Š The economy is not diversified and is highly dependent on the agricultural sector;

services and apparel only make up a small percentage of the economy.

â-Š High cost of finance and limited access to long term finance options

â-Š Largely unskilled labor force: limited spending on education has led to a decline in

attendance and in the quality of education 8

â-Š Political instability and safety risks, political, ethnic threaten to undermine stability.

â-Š Slow pace of reform due to government bureaucracy and lack of alignment of

policies at the various levels of government â-Š High levels of corruption, even within the judiciary, undermines investor confidence

Analysis of the topic:

ECONOMIC PHILOSOPHY

Regardless of the economic system followed by the new government the pledges and the statements made by Ministers make it abundantly clear that this government unlike the previous one would not be servile to the wealthy and would try to bring about an egalitarian system in the distribution of national wealth. Prior to the Wage Board’s announcement of its recommended minimum wage, the rate had remained unchanged at Tk950 for more than 12 years. Although the government may allow up to three years for the new wage to be implemented, and inevitably there will be compliance issues as manufacturers drag their feet, it seems politically untenable for wages to remain at their current levels given the unprecedented industrial unrest. In response to the Wage Board’s initial draft recommendation of a minimum wage of TK 604 to be increased to

Tk1, 800 after eight months, the BGMEA feared that over 50 per cent of factories would

be ruined within a short time.

While this claim is no doubt an exaggeration, the capacity of Bangladesh’s textile industry to absorb a significant wage hike as margins become tighter is a key question which hangs over the future of the industry. Bangladesh’s textile sector is concentrated in export processing zones in Dhaka and

Chittagong. These zones, which are administered by the Bangladesh Export Processing Zone Authority, aim to offer " a congenial investment climate, free from cumbersome procedures". They offer a range of incentives to potential investors including 10 year tax holidays, duty free import of capital goods, raw materials and building materials, exemptions on income tax on salaries paid to foreign nationals for three years and dividend tax exemptions for the period of the tax holiday. All goods produced in the zones can be exported duty free, in addition to which

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Bangladesh benefits from the Generalized System of Preferences in European and Japanese markets and is also endowed with Most Favored Nation status from the United States. Furthermore, Bangladesh imposes no ceiling on investment in the EPZs and

allows full repatriation of profits. The formation of labor unions within the EPZs is

prohibited as are strikes.

Bangladesh exports significant amounts of garments and knitwear to the EU market. Bangladesh also has significant jute, leather pharmaceutical, and ceramics industries. Bangladesh has been a lead in Western efforts to end the use of child labor in garment factories. In1995, the BGMEA, ILO, and UNICEF signed a memorandum of understanding on the elimination of child labor in the garment sector. Implementation of this agreement began in 1995, and by the end of 1999, child labor in the garment trade virtually had been eliminated. The labor-intensive process of ship breaking for scrap has developed to the point where it now meets most of Bangladesh's domestic steel needs. Other industries include sugar, tea, leather goods, newsprint, pharmaceutical, and fertilizer production

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Country note on Trade and Investment Policy Coordination

Country: Bangladesh

For ARTNeT Consultative Meeting on Trade and Investment Policy Coordination

16-17 July 2007, Bangkok, Thailand

Mr. Amitava Chakraborty and Muhammad Amin Ullah

1. International Trade in Bangladesh

Table – 1

(in million US $)

FY

Export

Export Growth(%)

Import

Import Growth(%)

Trade-GDP Ratio(%of GDP)

1999-00

5752

8. 26

8374

4. 60

29. 98

2000-01

6467

12. 43

9335

11. 50

33. 63

2001-02

5986

-7. 44

8540

-8. 50

30. 54

2002-03

6548

9. 39

9658

13. 10

31. 22

2003-04

7603

16. 11

10903

12. 9

32. 76

2004-05

8655

13. 84

13146. 70

20. 58

36. 33

2005-06

10526

21. 63

14746. 40

12. 17

40. 80

Table 1 indicates that during last 7 years total trade has registered double digit growth except in FY 2001/02. This has resulted in an increase of trade Trade-GDP ratio reflecting enhanced importance of foreign trade in the economy and the effort of the government to integrate the economy to multi-lateral trading system.

The major five items exported are Woven garments, Knitwear, Frozen food, Jute goods and Leather. In 2005-06 these items exported 4083. 82, 3816. 98, 459. 11, 361. 03 and 257. 27 million US $ respectively.

The five major imported items are Food products, Crude Petroleum & petroleum products, Chemical & fertilizer, Raw Materials & Accessories of

RMG and Capital Machinery. In 2005-06 these items earned 1449. 34, 2126. 65, 969. 01, 3928. 89 and 1630. 74 million US $ respectively.

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Five key measures/initiative/reforms undertaking to liberalize and facilitate trade

- Simplification of import procedures in line with the commitment with WTO system

- Duty-free import of Machineries and intermediate goods

- The total number restricted items for importing have been brought down to 25 from 62 in Import Policy order 2006-09.

- Export Policy of 2006-09 has provided for continuation of the provision for duty drawback and cash incentive for import.

- Complete withdrawal of 4% infrastructure development surcharge and merger of two slabs of supplementary duty at 15% and 25% into a single slab of 20%.

- Bangladesh has been following floating exchange rate regime since 2003.

Foreign Direct Investment in Bangladesh:

Actual FDI inflow in Bangladesh for the last four years:

Year

2003

2004

2005

2006

Fig. in US$

(million)

268

460

845

700*

Source: Bangladesh Economic Review 2007

Bangladesh is having investment potential in almost all sectors but recent trend shows that the under mentioned 5 (Five) major sectors are (100% foreign owned or under Joint-Venture) are taking the lead the share of them are as follows:

- Services-74. 84% (Telecom, Power, Oil, Gas & Hospitals);

- Textiles-8. 96%;

- Engineering 8. 81%;

- Agro based Industries-3. 20%

- Chemicals- 1. 61%;

Reforms Measures undertaken are:

- A Permanent Law Reform commission set up to ensure greater transparency and predictability in the way rules and regulation are made;

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- The Securities and Exchange Commission established in 1993 to oversee and regulate the operation of the stock market;

- Power generation, Air Cargo, Telecommunication, Air-transportation, Railway etc. are allowed in the private sector investment;

- BOI would set up Special Economic Zone (SEZ) in the country;

- The Company Law-1913 modernized in 1994 and further modernization is in process;

5 (Five) major Sectors where FDI is encouraging:

- Energy and Power generation;

- Mineral – Coal, Gas, Oil exploration;

- Ports, Highways, Bridges;

- Pharmaceuticals;

-Textiles;

Trade and Investment Policy Coordination- National level:

The overall trade and investment policy of the country is in fact composed of a number of policies, like a) Bangladesh Industrial Policy, b) Bangladesh Export Policy, c) Bangladesh Import Policy, d) Taxation Policy. However, various Ministries and organizations are involved in formulating and implementing these policies. According to the Rules of Business of the government, Ministry of Industry deals with investment issues, Ministry of Commerce deals with import and export policies and Ministry of Finance is involved with the fiscal and taxation policies. In the process of formulation and implementation of these policies, the concerned Ministry holds consultations with all the related government bodies, private sectors, stakeholders, think tanks, research organizations, academics, NGOs, members of the civil society and other related persons. In addition to holding consultation meetings, written comments are also sought from important agencies and bodies. Even in the process of implementation consultation meetings are being held on specific issues as and when necessary. There are also few standing bodies which meet regularly to review the issues and take decisions on various on-going issues. In fact, this is the system how trade and investment policies are being coordinated in our country. Though this system of coordination is going on in our country for a long time, sometimes it does not work up to the mark. Many important issues fail to be addressed properly just due to lack of proper coordination.

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For example, in each of our export policy projection, government declares few sectors as thrust sectors and keeps various provisions of facilities with a view to attracting investment in these sectors and increasing exports. However, every time it is found that expected outcome could not be achieved. One of the main reasons for not achieving the expected result is lack of proper coordination. So, I think we need to improve this system through which trade and investment issues could be better coordinated.

Trade and Investment Policy Coordination- Bilateral, Regional and Multilateral:

The international framework for financial and economic transactions has significantly changed with the presence of various multi-lateral, regional and bi-lateral trade agreements. Bangladesh is an active member of the World Trade Organization (WTO). Moreover, it has also been pursuing liberalization through many regional free-trade agreements like South-Asian Free Trade Area (SAFTA), BIMSTEC (comprising of Bangladesh, India, Myanmar, Sri Lanka and Thailand, including new members-Nepal and Bhutan) Free Trade Agreement and the Asia Pacific Trade Agreement (APTA). Bangladesh has also signed Preferential Trade Agreement with D-8 member countries. It is expected that all these RTAs will facilitate foreign investment and industrial relocation in Bangladesh. One of the objectives behind pursuing trade through these RTAs is to attract more foreign and local investment in the export oriented industries of the country. With this end in view every negotiating position is formed by consulting with the government and private sector bodies, along with other stakeholders, which are related to investment.

Findings:

Our conclusion so far has been based analysis on international trade. As we have been there are winners & losers when a nation open it’s self up to trade, but the wins to the winners exceed the losses losers. Yet the case for free trade can be made even stronger. There are other several other economic benefits of trade beyond those emphasized in the standard analysis.

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Here, in a nutshell, are some of these other benefits:

Increase variety of goods: Goods produced in different countries are not exactly the same German beer, for instance, is not the same as American beer. Free trade gives consumers in all countries greater Varity from which to choose.

Lower costs through economies of scale: some goods can be produced at low cost only if they are produced in large quantities -a phenomenon called economics of scale . a film in a small country cannot take full advantage of economies of scale if it can sell only in a small domestic market.

Increased competition: A company shielded from foreign s is more likely to have market power, which in turn gives it the ability to rise price above competitive levels this is a type of market failure. Opening up trade fosters competition and gives the invisible hand a better chance to work its magic.

Enhanced flow of ideas: The transfer of technological advance around the world is often thought to be linked to international trade in the goods that embody those advances. The best way for a poor agriculture nation to learn about the computer revolution, for instance is to buy some computers from abroad rather than trying to make them domestically.

Thus, free international trade increases Varity for consumers, allows firms to take advances of economies of scale, makes markets more competitive and facilitates the spread of technology. If the isolandial economists thought these effects were important.

Policy Recommendation:

Strategy issues for Policy Recommendations:

According to the Michael Porter definition of competitiveness Bangladesh is still under the factor driven economy. Bangladesh should go for the comprehensive and pragmatic policy to become a more competitive trading country such as- Broaden the country's sources of economic activity, including by diversifying exports particularly the agricultural commodities, to reduce external vulnerabilities and

promote growth. The government should provide supportive conditions that would facilitate the expansion and diversification of exports. The government should continue to support the growth of domestic demand and private-sector led investment through a reduction in government activity, which crowds out private investment. Significantly higher FDI inflows would be needed to support a higher growth environment in Bangladesh to compensate for domestic resource constraints and to enable Bangladesh to benefit from associated knowledge and