

TRADE RELATIONS WITH SAARC COUNTRIES AND TRADE POLICIES OF BANGLADESH

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This paper attempts to provide a synopsis of Bangladesh trade with the South Asian Association for Regional Cooperation (SAARC) countries and of its policies regarding bilateral and global trade. The common structure of the economies and the same intensive price competitiveness could lead to a great deal of formal trade between Bangladesh and the SAARC countries, but this potential is yet to be realised. Bangladesh suffers from a huge trade deficit with India. This paper will lay special emphasis on the trade relations with India and the proposed South Asian Growth Quadrangle consisting of seven north-eastern states of India, Bangladesh, Nepal and Bhutan. It will examine the impact of GDP and of the exchange rate and its variability on the export and import growth of Bangladesh. It will also examine the trade policies of Bangladesh with special reference to both nominal and effective tariff levels, and non-tariff barriers that hinder the growth of Bangladesh global trade with its neighbouring countries.

1. INTRODUCTION

The policy of trade liberalisation and free-market economy in the 1980s has created both challenges and opportunities for Bangladesh economy. The creation of the World Trade Organisation has created new ways of enjoying the comparative advantage for Bangladesh. At the same time, the globalised trade scenario has opened up the structural limitations of Bangladesh economy, which needs immediate attention through the formulation of appropriate policy and actions.

Bangladesh continues to suffer from a low-growth, high-poverty syndrome. However, Bangladesh has a large labour force willing to work for low wages resulting in a very competitive position for labour-intensive manufacturing exports. It has a large number of entrepreneurial businessmen who are able to develop and run small and medium scale

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enterprises. It has a sufficient amount of natural gas reserves which can potentially provide low-cost energy for a downstream industrial structure. With amicable and mutually beneficial regional cooperation, Bangladesh can be an ideal location for huge foreign direct investments, which can serve as a huge market for goods and services in the South Asia.

The growth potential of Bangladesh is, however, limited by a high population density and limited availability of land, which results in a continuing pressure on food supply. The low-income level makes it difficult for households to save, thus constraining the domestic development efforts. The education and health levels are low, resulting in a labour force lacking the skills needed for a modern economy. In addition, the traditions of central control of the economy and the awkwardness of government policy continue to work as a deterrent against private sector investment.

Within this global and regional trade scenario, this paper attempts to provide a synopsis of Bangladesh trade with the South Asian Association for Regional Cooperation (SAARC) countries and of its policies regarding bilateral and global trade. The common structure of the economies and the same intensive price competitiveness could lead to a great deal of formal trade between Bangladesh and the SAARC countries, but this potential is yet to be realised. Bangladesh suffers from a huge trade deficit with India. This paper will lay special emphasis on the trade relations with India and the proposed South Asian Growth Quadrangle consisting of seven north-eastern states of India, Bangladesh, Nepal and Bhutan. This paper will also examine the impact of GDP and of the exchange rate and its variability on the export and import growth of Bangladesh.

This paper will also examine the trade policies of Bangladesh with special reference to both nominal and effective tariff levels, and non-tariff barriers that hinder the growth of Bangladesh global trade with its neighbouring countries. Intra-SAARC trade is very negligible. This study will estimate a gravity model of international trade to examine whether intra-SAARC trade is lower or higher than what is predicated by the economic model. The results of this model will help us understand the possibilities of trade creation and diversion effects resulting from the South Asian Preferential Trading Arrangements (SAPTA) among SAARC member countries. Gravity models of international trade estimate the trade

flow as a function of variables that directly or indirectly affect the determinants of normal trade flow. The typical gravity model specification relates bilateral trade to income, population (or per capita income) and distance between the trading partners. If one finds a positive coefficient on the dummy variable indicating that two countries, both of which participate in the same preferential arrangement, trade more with one another than predicted by their incomes and distance, then the conclusion drawn is that the arrangement is trade-creating for its members. This paper will review the tariff concessions agreed upon by the SAARC member countries.

The paper is organised as follows. Following the introduction, section II deals with the structure and performance of the foreign trade of Bangladesh. Section III reviews the trade policies of Bangladesh. Section IV presents a detailed historical analysis of bilateral trade and exchange rate position between Bangladesh, India and the South Asian Growth Quadrangle Countries. Section V provides the results of a gravity model of Bangladesh trade with its SAARC partners and the rest of the world. This section also sheds light on the potentially tradable products among SAARC member countries. Section VI provides policy recommendations for increasing Bangladesh foreign trade while section VII concludes the paper.

2. THE STRUCTURE AND PERFORMANCE OF FOREIGN TRADE OF BANGLADESH

2.1. Structure and performance of exports of Bangladesh

The volume of major export categories is presented in Table 1. Bangladesh's export sector sustained its robust growth in Financial Year (FY) 1997 with export earnings rising to \$4.4 billion, indicating a growth rate of 14% over FY 1996. The rate of growth of exports was, however, slightly better compared to FY 1995 when exports registered a growth of 11.8% compared to the previous year. The readymade garments (RMG) and knitwear appear to be the largest export categories both in terms of volume and growth during the 1992-97 time period. Knitwear export growth rate (52%) dominates the RMG growth (6%) during this time period. Knitwear is a variant of readymade garments. The only difference is that RMGs are made out of finished fabrics whilst knitwear weaves yarn

into a readymade garment. If RMG and knitwear are combined together, this accounted for \$2228.35 million of exports in FY 1995 which grew by 14.31% to \$2547.13 million in FY 1996. However, the local value addition from knitwear comes to more than 50%, while that from the RMG averages only 25%.

It is important to remember in this context that the rules of origin (ROO) for accessing EU GSP schemes require a three-stage value addition in the case of knit RMG, whereas in the case of woven RMG a two-stage value addition is enough. In recent years, the EU has raised objections on the ground that Bangladesh has failed to abide by ROO provisions in respect of knit-RMG products, and has threatened to discontinue the concessionary treatment for these exports. This reinforces the argument that if Bangladesh is to continue commanding market access to European countries and hopes to enhance the export performance of the promising knit RMG sector to the EC, then there is no alternative to establishing strong backward linkages in the RMG sector.

The failure to promote backward linkages to supply the RMG sector with intermediate inputs, in the way of yarn, fabrics and other inputs will seriously threaten the RMG and knitwear industry after the post-MFA era. Unless Bangladesh has significant backward linkages of its own, it may, in the wake of the phasing out of the MFA, lose ground to its various sources of fabric supply, such as India, as well as to countries with a highly integrated textile industry which could subsidise input costs to their own RMG sector whilst starving Bangladesh of those inputs necessary for her to retain her market share. Unless a full-fledged product and export development programme, including diversification away from the dependence of Bangladesh on North American and European community markets takes place, Bangladesh's capacity to sustain its export capability in the next decade may be compromised.

Table 2 shows a breakdown of primary versus manufactured goods. Out of total export earnings of US\$4.4 billion, primary goods accounted for only 12%, whereas manufactured goods accounted for 88%. Table 3 shows export earnings of both traditional and non-traditional goods for the 1982-1997 period. Export earnings from traditional goods declined from 69% of total exports in 1982 to 10.6% in 1997, whereas the share of non-traditional goods rose from 31% in 1982 to 88.4% in 1997. Table 4 shows

the export volume of jute and non-jute goods. During the 1996-97 period, jute items accounted for 9.83% whereas non-jute items accounted for 90%. These figures show a regular improvement of non-traditional exports and a gradual decline of jute exports, which used to dominate Bangladesh's export sector.

Table 5 shows the country-wise export figures. The increasing importance of the USA as the major export destination and the structure of exports to the USA (RMG exports to USA accounted for 76.7% of total exports to the USA in FY 1995, whilst the matched figure for knitwear was 8.3%) would suggest that along with the growth in commodity concentration there has also been a corresponding market concentration over the past years. Three countries accounted for over half of Bangladesh's total exports, whilst the top 10 countries account for almost two-thirds of Bangladesh exports. In spite of efforts to widen Bangladesh's export market base, there has not been any significant breakthrough in recent years in the diversification of Bangladesh market. The shares of countries such as India, Russia and France have been in regular decline in recent years. The fall in the share of India, Bangladesh's principal source of imports, is particularly noticeable. Outside the USA and the EC markets, only Hong Kong's and Japan's shares in total exports have registered some increase in the 1990s - exports to these countries registered a growth of 49.5% and 64.4% respectively in FY 1995. Exports to the USA increased by 62.2% over the same period. Table 6 shows the export value, volume and unit price of major items during the 1990/91-1995/96 period. These figures show that Bangladesh export growth was not merely only a result of price increases, but also a result of volume increases.

2.2. Structure and performance of imports of Bangladesh

In contrast to export growth, Bangladesh import growth has remained much less robust, in spite of impressive progress in import liberalisation. Bangladesh has, since the 1980s, realised major advances in eliminating quantitative restrictions (QRs) and reducing protection to Bangladesh imports. By 1994 only 30 import items remained exposed to any form of trade-related QRs, as opposed to 429 items being covered by QRs in 1986. Average nominal tariffs, on a trade-weighted basis, are now down to 21% in 1995, with a low of 11.3% for capital goods and a high of 25% on final

consumer goods. These are tariffs levels which may still be below East/Southeast Asian rates, but for one of the world's poorest and as yet highly undiversified economies such as Bangladesh, this level of trade liberalisation is not an insignificant achievement.

Table 7 shows the growth rate of imports into Bangladesh over the 1993-1996 period. Compared to the rates of growth in FY 1993 and FY 1994 which were 7.4% and 6.2% respectively, the rate of growth in imports of 38.6% in FY 1995 was indeed quite significant. It is noticeable that imports continued to demonstrate robust growth in FY 1996. Imports increased by about 24.8% compared to FY 1995. If the structure of growth of imports in FY 1996 is analysed, it can be seen that for primary and final consumer goods the growth rate was about 15%, whilst the corresponding rates for intermediate and capital goods were 21.5% and 50.9% respectively. This has resulted in a shift in the structure of imports in favour of production-related imports. Table 8 shows the structure of imports into Bangladesh for the 1993-1996 period. In FY 1996, the share of production-related imports (intermediate inputs and capital goods) accounted for 64.8% or about two thirds of total imports while the share of consumption related imports (primary and final consumer goods) accounted for 35.2% of total imports.

Table 9 shows the structure of imports into Bangladesh by major countries. A review of Bangladesh's import market structure indicates that import sources have undergone some important changes in recent years, with the emergence of India as the major source of imports to Bangladesh and the decline in importance of such major import sources as the USA, Japan, Singapore and South Korea. India has, over the last five years, climbed from the 7th position to that of the most important import source for Bangladesh. India supplied about 12% of total imports to Bangladesh in FY 1995, thereby doubling its share of 6%, registered in FY 1991. In contrast, Japan's share declined from a high of 10% in FY 1991 to only 4.6% in FY 1995. On the other hand, China and Hong Kong have remained important import sources in the 1990s, together contributing about 14% of the global imports coming into Bangladesh (Centre for Policy Dialogue, 1996).

The emergence of India as the major import source and the resulting negative balance of trade, however, conceals the fact that a significant part

of the imports from India go to export-oriented industries as inputs, which in turn results in a positive balance of trade with other trading partners such as the U.S.A. For example, cotton yarn and fabrics accounted for about one-third of Bangladesh's imports from India in FY 1995. However, as is known, the official trade of Bangladesh with India does not reflect the actual traded volume between these two countries. According to the findings of a recent survey, the volume of unofficial exports to Bangladesh is estimated to be about 2528.2 crore taka or \$630 million (Bakht, Z. 1995). If this unofficial trade is taken into account, India's share in total imports will go up from 12.1% to about 21.1%.

Table 10 shows imports and exports and the overall trade balance for the 1979-1996 time period. The figures show that Bangladesh's external formal trade balance has deteriorated over the years, with a trade deficit of US\$853 million in 1978/79, which declined to a deficit of US\$2944 million. However, Bangladesh exports have also increased over the years. Table 11 shows the export earnings as percentage of imports from 1983 to 1996. Bangladesh exports now account for a higher percentage of import bills (57% in 1996) compared to the 1980s.

2.3. Exchange rate policy of Bangladesh

Table 12 shows that, in the early 1990s, a substantial reduction in the external deficit was achieved without a significant real devaluation of the taka, although the real effective exchange rate computed by the IMF showed a secular appreciation in its value since the beginning of the 1990s. Although exporters were demanding a drastic devaluation of the taka, policy makers were reluctant to do so in a situation of rising reserves and rapid liberalisation in Bangladesh trade regime. It was also not clear whether devaluation, while promoting exports, would induce a more positive investment response. It is to be noted here that while over the last three years, between FY 1992 and FY 1995, the Bangladesh taka was devalued by 15%, over the corresponding period, Pakistan devalued its currency by 40%, India by about 90% and Sri Lanka by more than 35%. An analysis of the behaviour of the real exchange rate is important for understanding whether the country should devalue the currency, and if so, then by how much. An open economy, which competes with the rest of the world for export markets, must endeavour to maintain a correct real exchange rate of its currency. If its currency is overvalued, its

competitiveness is weakened and the country might have to face the consequence of losing ground in its export markets.

Hassan and Tufte (1998) estimated an aggregate export demand function for Bangladesh by employing multivariate cointegration and error-correction models. They postulated that real exports depend on foreign economic activity, foreign as well as domestic prices and exchange rate volatility. These results indicate that the volume of world trade and exchange rate volatility dominate long-term Bangladeshi export growth. Table 13 shows the results of this export model. They find that export elasticity with respect to exchange rate volatility and volume of world trade are -0.5 and 0.73 respectively. None of the price effects on export growth are found to be significant. The finding that the Bangladeshi export growth is determined more by the volume of world trade and exchange rate volatility than by changes in domestic and foreign prices has one important policy implication. The policy makers should follow a stable equilibrium exchange rate without abruptly changing it too frequently.

3. A REVIEW OF TRADE POLICIES OF BANGLADESH

3.1. A review of export strategy

The government's commitment to exports with a particular emphasis on expansion of non-traditional export is to be found in the Export Policy Order (EPO) 1993-1995. The EPO outlines the general thrust of the strategy with the incentive regime built around it. While most incentives address the profitability concerns of exporters in general, the strategy is clearly to promote the growth of non-traditional exports.

On the basis of Bangladesh's resource endowment (cheap and abundant unskilled labour and plentiful proven reserves of natural gas), there is a presumption of potential comparative advantage in the following commodity groups: yarn and textile fabrics as inputs into the garments sector, various leather products (such as shoes, luggage, bags), fish processing, chemical products using natural gas as feed stock, and numerous speciality products based on jute fibre.

Two facilities that have been operating successfully for garment exporters are the private bonded warehouse and the special bonded

warehouse, both of which permit duty-free importation of inputs for ready made garments under back-to-back letters of credit (L/C). Recently, the special bonded warehouse facility has been extended to cover non-garment export industries (such as leather products) and input imports under a more flexible arrangement without back-to-back L/Cs. More recently, NBR has taken a significant step forward in allowing duty-free imports of capital machinery to 100% export-oriented industries. The Duty Exemption and Drawback Office (DEDO) of NBR was recently revamped under the Export Development Project (EDP) to streamline procedures and expedite disbursement of duty drawbacks on an actual or flat rate basis. Setting up of export processing zones (EPZ) with tax and duty-free privileges and adequate provision of infrastructure facilities have encouraged some foreign and domestic investors to set up industries in the non-garments sector.

Until recently, the trade regime in Bangladesh was geared toward a strategy of import-substituting industrialisation with heavy protection to domestic activities, without regard to considerations of efficiency or domestic resource costs. This scenario is changing, though not as rapidly as is warranted by the present highly competitive international trade scene.

The anti-export bias of the trade regime in Bangladesh is evident from the tariff structure consisting of high nominal and effective tariff rates, a quota rationing scheme that generates undue rents on imports and an exchange rate that is typically overvalued. This situation is fast changing with trade policy switching from an inward-oriented strategy of import substitution to an outward-looking strategy of export promotion based on the economy's existing and potential comparative advantage.

The tariff rates have gone down substantially in the 1990s. Table 14 shows import-weighted tariffs which had come down from 24% in FY 1992 to 20.9% in FY 1995, and further declined to 16.7% in FY 1996. The nominal tariff rates which had declined from 57% in FY 1992 to 25.9% in FY 1995 continued to decline, falling to 22.3% in FY 1996. Bangladesh's nominal import protection level currently ranks among the lowest in South Asia. The highest tariff slab was also reduced from 60% to 50%. Table 15 shows the dynamics of tariff reductions until FY 1996. These data further reveal that between FY 1995 and FY 1996 the highest reduction of (import-weighted) tariffs had been on the capital goods sector where tariffs

were reduced by more than 31%. Import-weighted tariffs have, in fact, declined for all categories of imports, although, not in a uniform manner. In fact, compared to FY 1995, imports of zero-rated commodities increased by about 82% compared to 16% for commodities with zero-plus import duties.

Table 16 shows the removal of quantitative restrictions of Bangladesh foreign trade. In recent years, the number of quantitative restrictions (QRs) has come down significantly. In the 1990s, almost one-fourth of all items under 4-digit headings was subject to QRs. In 1996 QRs were retained on only 119 items, which contributed only 2% of total imports. According to the 1997 Import Policy the number of 4-digit headings subject to QRs for trade reasons were further reduced from 40 to 23, although the total number of QRs registered a slight increase from 109 to 114 in 1996.

The number of products still remaining under import bans or restrictions are now limited to only 27 items, mainly in the textile sectors, where some import substitution is taking place. It is however unclear whether any of these 27 banned items remain immune from the process of 'unofficial' imports which remain a growing source of Bangladesh's total imports.

On the matter of tariffs, Bangladesh has taken only the first steps toward achieving the goal of uniform tariffs-system that ensures non-discriminatory protection, besides adding the qualities of clarity, simplicity, and transparency to tariff administration. To improve productive efficiency, several anomalies in that tariff structure have been addressed (e.g., eliminating multiplicity of rates for similar products, removing discriminatory rates between end-users, reducing dispersion in the tariff structure, and conforming to only seven tariff rates overall). Finally, the publication in July 1993 of the Bangladesh Operative Tariff Schedule 1993-1994 has presented in one document complete information on trade taxes and fees for the benefit of, among others, domestic producers and potential investors (Sattar, 1997).

A key ingredient of trade liberalisation is the replacement of quota rations with equivalent tariffs. The government of Bangladesh has, in most part, subscribed to the principle of having tariffs as the only protective instrument, and limiting quota rations to those imports that need to be

restricted for non-trade reasons (e.g., health, religion, national security, or environment). Owing to the hitherto complex system of quota rations that often combined trade and non-trade arguments, no effort has been made to devise tariff equivalence of any sort. Instead, a principle of “dual CD maxima” has been accepted: 45% maximum CD on revenue grounds and 75% maximum CD on protection grounds.

3.2. An assessment of the export incentive schemes

Export incentives provided in Bangladesh can be broadly grouped into (a) assistance to gross value added or returns to primary factors, (b) assistance to inputs or intermediates and (c) assistance to output. The major thrust of these incentives is directed towards (a) ensuring that policy and administrative constraints on export activities are alleviated, (b) enhancing backward linkage and value addition, (c) diversifying exports, (d) promoting export-oriented investment, and (e) injection of price competitiveness in global markets. Table 17 summarises the principal export incentives in place and their impact on Bangladesh’s export regime. The principal policy interventions which have influenced the incentive regime for exporters in recent years may be identified as: 1) a general reduction in tariff levels; 2) increase of cash compensation to non-traditional exports from 15 per cent to 25 per cent; 3) elimination of dual exchange rates and convertibility of the taka on current accounts; 4) extension of BW facilities to some non-RMG products such as leather; 5) provision for duty free imports of machinery for export-oriented units; 6) relaxation of foreign exchange retention limits.

On the other hand, the withdrawal of cash subsidies on export credits (currently within the lower band of 8.0 to 10.0 per cent) has negatively impacted on the incentive to export. On the whole, the above policies have significantly reduced the anti-export bias of the trade policies (Rab, 1989) which was very much in evidence during the 1980s.

Table 18 gives an idea about the scope and dimensions of some of the major export incentives currently in place in Bangladesh. Some of the current policy changes have also lessened the difference between incentives enjoyed by direct exports and deed exports and between EPZ units and 100 per cent export-oriented units outside the EPZ. The impact of different incentives varies across sectors (Roy, 1994) as well as between

the stages of production. Whilst incentives such as the cash compensation scheme, operated by Bangladesh Bank, is targeted to enhance backward linkage and the duty-free import of machinery is intended to promote export-oriented investment, incentives in the way of the ECG operated by Shadharan Bima Corporation is intended to sever marketing risks.

4. TRADE RELATIONS AMONG BANGLADESH, INDIA AND SOUTH ASIAN GROWTH QUADRANGLE

Any current attempt to sustain exports points to the need for improving Bangladesh's bilateral trade relations with India. This involves the need for a rapid move towards removal of QRs by India and providing zero-tariff access to Bangladesh's exports to the Indian market. Thus far the trade balance with India remains heavily in deficit. This persistent and growing trade deficit with India demands attention because of its political as distinct from its economic implications. Such implications appear to suggest a need for diplomatic attention since the market mechanism remains imperfect due to the asymmetry in the economic structures as well as in the policy regimes of the two countries.

4.1. History of trade relations with India

Immediately after independence, Bangladesh concluded a General Trade Agreement with India in March 1972. Among other things, this Agreement provided for border trade between Bangladesh and neighbouring Indian states of West Bengal, Assam, Meghalaya, Tripura and Mizoram. Free trade in certain commodities was allowed within 16 kilometres of both countries' borders. The Trade Agreement of 1972 was replaced by another Trade Agreement signed on July 5, 1973 for three years. In subsequent periods, border trade was found to be inadequate for the growth of formal merchandise trade; therefore, border trade was discontinued under the 1973 Agreement. This agreement provided for the most favoured nation (MFN) treatment and a system of balanced trade and payment arrangement (BTPA). The BTPA system was replaced from January 1, 1975 by payment through freely convertible currencies. This agreement was renewed until September, 1980.

A Third Trade Agreement was signed on October 4, 1980 initially for three years. The agreement was renewed a number of times. On October

24, 1995, the existing trade agreement was further renewed for three years until October, 1998. Under the third Trade Agreement, an Inland Water Transit and Trade Protocol between Bangladesh and India was concluded in August 1982. This protocol provides for making the inland waterways of both the countries available for trade.

4.2. Balance of trade with India and bilateral exchange rate

Tables 19 and 20 show the composition of exports to and imports into Bangladesh from India respectively. While Bangladesh imports mainly textile and textile-related raw materials from India, Bangladesh's major export to India happens to be chemical and allied products. Table 21 shows the bilateral trade between India and Bangladesh since 1972. These figures clearly show that India always had a trade surplus with Bangladesh, which now amounts to a cumulative US\$4.659 billion dollars. This worsening trade situation should concern the policymakers of Bangladesh since India happens to be a powerful and larger economy bordering on Bangladesh. Moreover, Bangladesh economy, in many ways, is similar to that of the Indian economy. In FY 95 Bangladesh's exports to India accounted for only 1.3% of her total exports. In contrast, India is currently the major source of imports to Bangladesh accounting for about 12.2% of her total imports. The bilateral balance of trade with India has traditionally been in deficit but in recent years this deficit has been increasing at a very high rate.

Table 22 presents bilateral exchange rates between India and Bangladesh during 1974-1995 in order to investigate the dynamics underlying this expansion in the bilateral trade imbalance. Taking 1985 as the base year, the taka underwent a real depreciation against the Indian rupee in 1986 which was somewhat arrested in 1987. The taka once again started to appreciate in 1988 and the downward movement of the real exchange rate continued until recently. In 1995, the taka remained appreciated against the Indian rupee--the magnitude of real appreciation being about 30% compared to the base year. Thus the large nominal appreciation of the taka vis-à-vis the Indian rupee was accompanied by a significant appreciation of the real exchange rate. The misalignment in the bilateral real exchange rate might thus have contributed to the expanding Indo-Bangladesh trade imbalance.

Bangladesh competes with India for its export market for a number of its important exports. Bangladesh cannot perhaps afford to lose its price

competitiveness to India because of an appreciated taka and expose itself to a fall in the demand for its exports, to the extent that such exports are responsive to prices.

There are two views regarding the impact of the exchange rate on the Indo-Bangladesh bilateral trade. One view states that the large imbalance of trade between India and Bangladesh is a result of the inappropriate exchange rate policy on behalf of Bangladesh. India has consistently pursued an interventionist exchange rate, better known in economics text book as "beggar-thy-neighbour" policy, which simply says that the purpose of such policy is to divert demand from foreign goods to its own, and as a result take away jobs and income from one's trading partners. Such depreciation does not increase total demand or create net income or jobs, which is the objective of free trade. India has successfully exported unemployment to Bangladesh and its other trading partners in order to create domestic employment. In order to have a level-playing field, this view subscribes to a competitive devaluation of taka against the Indian rupee.

The second view looks at structural factors driving the trade imbalance which are located in the much larger size, diversity and technological maturity of the Indian economy compared to Bangladesh. The geographical proximity of India along with the increasing familiarity of Bangladesh's importers to India's production capacities which in recent years have become globally more competitive both in terms of price as well as quality has made Indian products increasingly competitive in Bangladesh's market. Bangladesh's import liberalisation, now reintroduced by an increasingly porous border which circumvents virtually the entire land boundaries of Bangladesh, has turned Bangladesh virtually into an open market for India and one of its fastest growing areas of export opportunity.

The only feasible policy of addressing the growing imbalance, short of a general reversal of the process of import liberalisation backed by draconian steps to restore the security of the borders against illegal trade penetration, is to explore avenues to enhance Bangladesh's exports to India. This will demand measures within India to improve opportunities for market access for Bangladesh's exports through providing withdrawal of all QRs as well as elimination of tariffs on all Bangladeshi exports. Such a move will only be of limited benefit to Bangladesh in the short run,

but over the longer period will encourage local, Indian and regional investors to locate investment in Bangladesh targeted to the larger Indian market. It is this approach to correcting the growing trade imbalance which has come under focus in the area of informal diplomacy, and more recently, in the area of formal diplomacy. It is in this context that the issue of preferential trading arrangements in south Asia has assumed considerable importance.

In order to improve the trade balance with India, the policymakers should consider the following: 1. Competitive devaluation of the Bangladeshi taka; 2. Reinforce the border patrol to stop informal trade; 3. Actively seek tariff and non-tariff cuts on Bangladeshi exports to India; and 4. Strengthen the already existing bond of SAARC and expand this bond into meaningful economic relationships.

4.3. Bangladesh and South Asian Growth Quadrangle

It is argued that the South Asian Growth Quadrangle (SAGQ) will have several beneficial effects for both India and Bangladesh. In particular, for Bangladesh: (a) it will create a market for consumer goods--examples being poultry and meat products, toiletries and pharmaceutical items--for Bangladesh, since currently such consumer goods have to be transported in a roundabout fashion from the main part of India; (b) it will help Bangladesh by allowing its access to electric power (especially hydroelectric) as well as other forms of energy, such as coal, from an energy potent region; (c) minerals from the north-eastern states and production/transportation facilities from Bangladesh can be combined to produce low cost intermediate goods such as cement. These goods can then be used domestically in Bangladesh and India, or exported abroad; (d) the relatively abundant natural gas in Bangladesh can be used to produce appropriate intermediate goods such as urea using joint production facilities with India, which can then be sold to the NES; (e) Bangladesh can earn substantial revenues by allowing transit of goods from the rest of India to the NES. Such goods can compete with goods produced in Bangladesh through joint venture programmes with Indian/other foreign companies and targeted towards the NES.

M. Rahman (1997) and Dubey (1995) report the following benefits for Bangladesh: (a) Bangladesh will earn about Rs 600 crores (= \$150 million approximately at current exchange rates) by way of freight and

other charges leviable on Indian goods. This includes earnings from facilities to be provided at the Chittagong port for the transshipment of Indian goods; (b) India will be prepared to invest a sum of \$200 million for the expansion of Chittagong port to enable it to handle the additional volume of Indian cargo; (c) Bangladesh could develop an export trade of \$50-\$100 million with India's NES; (d) Bangladesh's export earnings to Nepal could increase by \$50-\$100 million because of the provision of transit facilities by India; (e) Nepal's export earnings to Bangladesh and to destinations beyond are also likely to increase; (f) Nepal is willing to invest for the expansion of the Mongla port in Khulna; (g) With the granting by India of transit facilities for trade between Bhutan and Bangladesh, there will be an increase in the two-way trade between these countries.

Yusufzai (1998) estimates the size of Bangladeshi exports by an indirect method. Under very liberal assumptions, the market size for Bangladesh's exports to India's NES is more likely to be around \$27 million rather than \$50-\$100 million as suggested by Dubey. But even assuming that the estimated export market size of Bangladesh was underestimated by a factor of 10, this would still take the market size only up to \$272 million. This is higher than the 1997 leather exports but less than the frozen food exports. Then the question becomes one of whether the opportunity cost (in terms of perhaps using the funds to create conditions for increased exports of leather and/or frozen food on a world-wide basis) of the substantial infra-structural investment that would be required is justified by the potential returns. Dubey's estimate of revenues from transit (including port) services is \$150 million. Bangladesh earned \$506.6 million from frozen food and leather exports in 1997. If one accepts Dubey's figures, transit revenues would constitute about 30% of the earnings from these exports.

In the long run, in addition to providing access to its transport system, Bangladesh has to invest heavily in infrastructure development. Ports have to be upgraded/modernised, rivers have to be dredged on a regular basis, roads have to be improved in a manner suitable for intermodalism (including carrying of containers across bridges and culverts), and railway tracks have to be harmonised (or at least arrangements have to be made so that the transfer from broad gauge to metre gauge or vice-versa can be done quickly and efficiently).

From a physical infrastructure point of view, there seems to be a time-based asymmetry in the distribution of benefits from regionalisation between India and Bangladesh. To see this, one can divide the benefits to Bangladesh in three ways: (i) benefits accruing to Bangladesh through selling of transport services that require a minimum of new physical investment, e.g., providing transit facilities to India's NES; (ii) benefits accruing to Bangladesh following some new investment, e.g., providing access to the ports to India, Nepal and Bhutan (iii) benefits accruing to Bangladesh following substantial multi-country investment, e.g., energy generation through hydroelectric projects, natural resource/gas based joint ventures with the Indian NES.

As can be ascertained, Bangladesh stands to gain the most from the items in category (iii). Yet from India's point of view, it gets the most benefits from items (i) and (ii), since India can easily satisfy its demand for energy through joint ventures with Nepal without involving Bangladesh. Secondly, with access to transit facilities through Bangladesh, the importance of joint ventures to service the NES is reduced, as these have to be developed against the wishes of the local population of the NES.

Summarising the points above Yusufzai (1998) finds that (a) the initial benefits from regionalisation are small, both overall and compared to other alternatives; however, these are available with a minimum of new investment on the part of Bangladesh; (b) there are non-economic aspects of these benefits which an economist is unqualified to judge; (c) other benefits which are more substantial will require significant investment of time and other resources on Bangladesh's part; (d) they also involve multi-country collaboration; (e) there is asymmetry in the time distribution of benefits between India and Bangladesh.

5. THE GRAVITY MODEL OF BANGLADESH TRADE WITH THE SAARC AND THE WORLD

5.1. International trade of the SAARC countries

SAARC consists of seven members of South Asia: Bangladesh, Bhutan, India, Nepal, Maldives, Pakistan, and Sri Lanka. All the SAARC countries are poor nations of the world. Disparity in income among these countries

is also small. Trade amongst the SAARC member countries has traditionally been insignificant. As Table 23 shows, intra-SAARC trade, which currently stands at 3.7% of their total global trade, is currently less than what it was in the 1980s when it was 5%. In the area of exports, for a number of commodities SAARC member countries compete intensely with one another in the international market. Even among the non-oil producing developing countries, the trade share of SAARC countries is no more than 4% to 5%. Further, intra-SAARC trade is quite small, only about 3% of the total trade of this region. Even before the implementation of trade liberalisation among the original six members of EEC, intra-EEC import was more than 25% of total imports while intra-SAARC import counted only about 2% of total imports of these 5 countries (See CPD, 1996). The question is why intra-SAARC trade is so limited. This might be either a natural economic outcome or because of unexplored trade opportunity.

The low volume of intra-regional trade can be partly explained in terms of the traditional theory of comparative advantages based on factor proportions. This theory predicts that the volume of trade is positively correlated to the inter-country differences in relative factor endowments. The intuition behind this theory is that countries with different relative factor endowments will have different autarky production trade-offs and, left alone, markets will take advantage of these trade-offs, creating gains from specialisation and exchange. In its traditional form, Heckscher-Ohlin trade theory focuses on differences in relative factor endowments of human capital and natural resources. However, in all its forms, the theory assumes constant returns to scale and free access to technological knowledge.

In the area of exports, for a number of commodities SAARC member countries compete intensely with one another in the international market. Bangladesh and India compete in the markets of U.S.A. and EC in exporting such tradeables as jute and jute goods, while all the major SAARC countries compete with each other in the exports of ready-made garments in the markets of the developed countries. In the case of textile exports, the competition is tough between India and Pakistan whereas Pakistan, Bangladesh and India compete with each other in exports of leather and frozen fish. India and Sri Lanka are major competitors in the markets for processed gems, diamond and jewellery. The competition

among most of the SAARC countries for textiles and apparels markets, especially in the U.S.A., is expected to accentuate with the phasing out of the Multi-fibre Agreement.

Among the 7 SAARC countries only India and Pakistan enjoy a positive intra-regional balance of trade. As for Bangladesh, its intra-regional trade accounts for about 15% of Bangladesh total global trade. The major trading partners of Bangladesh within South Asia remain India and Pakistan, which together account for more than 95% of Bangladesh imports from SAARC countries and 75% of Bangladesh exports to the SAARC countries. Bangladesh's balance of trade has always remained negative with India and the gap has been rising over the past decade. The trade deficit has in fact gone up by 10 times over the period 1985-1995. Moreover, the unofficial cross-border trade between India and Bangladesh is quite substantial, the estimates ranging from 50% to 150% of the official trade. The unofficial trade between India and Pakistan is estimated to be about \$0.5 billion. However, a substantial amount of the input (about 33% of total official imports) imported from India, constituting mainly fabrics and textile inputs, goes into export-oriented industries. This would indicate that the fact of a growing negative balance of trade with India should not be interpreted in isolation, and outside of its global trade relations.

Whilst trade links within South Asia, except perhaps between India and Pakistan, are increasingly being determined by market forces, the establishment of a preferential trade area in South Asia, dismantling of para- and non-tariff barriers and the across-the-board reduction (and ultimately, removal) of tariffs are expected to have important consequences for the economies of the SAARC member states in terms of trade creation and trade diversion. However, till now the depth and coverage of the tariff adjustments have been narrow and shallow, covering only 226 items, which contributes less than 3% of the total number of commodities traded among the SAARC countries. From Table 24, it is evident from the above analysis that the concessions received and offered till now, under SAPTA, are at best modest. Since preferential imports cover less than 3% of total intra-regional imports of the SAARC countries, the total value of customs revenue foregone following preferential imports under SAPTA does not exceed \$50 million (Mukherjee, I.N., 1995).

SAPTA has come into force only in 1995, following ratification by all its member countries. It is thus problematic to capture the actual impact of SAPTA on the intra-regional trade of the South Asian countries. A recent study (Srinivasan and Canonero, 1994) has tried to estimate the potential impact of SAPTA in terms of intraregional trade. The study found that SAPTA's impact is expected to be positive for the smaller regional countries such as Bangladesh and Nepal whose trade is expected to go up by 8% to 12%, while for India and Pakistan the incremental trade will be about 2% to 4%.

5.2. Methodology and data

Gravity models offer systematic frameworks for measuring the normal pattern of trade. International trade flows are determined by comparative advantage, possibility of intra industry trade, transport cost, etc. Trade policy may revise the normal trade flows. Gravity models of international trade estimate the trade flow as a function of variables that directly or indirectly affect the determinants of normal trade flow. One can use the gravity model to examine whether a lower magnitude of intra-SAARC trade is a normal outcome or not.

The gravity model has long been used for empirical studies of the pattern of trade. Specifically, the volume of trade between two countries should increase with their real GDPs (the so-called gravity variable), since large countries should trade more than small ones, and with per capita incomes, since rich countries should trade more than poor ones. It should diminish with geographical distance because proximity reduces transportation and information costs. Since the dependent variable in the gravity model is bilateral trade between pairs of countries, each variable (other than distance) is entered in product form. Researchers then add dummy variables for participation in various preferential arrangements. If one finds a positive coefficient on the dummy variable indicating that two countries, both of which participate in the same preferential arrangement, trade more with one another than predicted by their incomes and distance, then the conclusion drawn is that the arrangement is trade creating for its members. If there is a negative coefficient on the dummy variable indicating that only one member of the pair participates in a particular preferential arrangement, this is taken as evidence of trade diversion vis-à-vis the rest of the world.

The typical gravity model specification relates bilateral trade to income, population (or per capita income) and distance between the trading partners:

$$\log(\text{TRADE}_{ijt}) = a + B_1 \log(Y_{it}Y_{jt}) + B_2 \log(P_{it}P_{jt}) + B_3(\text{DIST}_{ij})$$

Where TRADE_{ijt} is bilateral trade between countries i and j at time t (measured in U.S. dollars), Y is real income (the so-called gravity variable), P is population, and DIST is distance. As trade is expected to increase with size and per capita income and to decline with distance, B_1 should be positive, B_2 and B_3 negative.

Annual data on bilateral trade flows among SAARC countries has been collected from IMF's Direction of Trade Statistics. The UNCTAD and the United Nations COMTRADE database has also been used to compare import and export trade flows of SAARC countries. Disaggregated data on Bangladeshi imports and exports have also been collected from Bangladesh Bureau of Statistics and Ministry of Commerce. A substantial amount of data has also been collected by hand from different government documents. Interviews and surveys with important government policy makers, researchers and politicians have also been conducted to supplement the quantitative research with qualitative answers.

5.3. Analysis of empirical results

A more systematic way of adjusting for the natural determinants of trade is by means of the gravity model. The assumptions of the model are that trade between two countries is proportionate to the product of their GNPs and to the product of their per capita GNPs; an increasing function of adjacency (when two countries share a common land border) and inversely related to the distance between them. Dummy variables are added when both countries in a given pair belong to the same regional grouping. This provides a means of determining how much trade within each region is due to factors common to trade throughout the world and how much remains to be explained by regional effects.

Table 25 provides the descriptive statistics of all explanatory variables and regional blocs used in this study for the year 1994. Regional bloc

variables are used in this analysis in three ways. First, seven dummy variables for regional blocs of countries--SAARC1, SAARC2, ASEAN1, ASEAN2, NAFTA, EEC1, and EEC2--with which Bangladesh has regular and significant trade are used in this study. SAARC1 bloc consists of Bangladesh, India, Nepal and Bhutan, whereas SAARC2 bloc consists of all seven members (the remaining members are Pakistan, Sri Lanka and Maldives). ASEAN1 consists of Indonesia, Malaysia, Philippines, Thailand, Singapore and Laos, whereas ASEAN2 consists of ASEAN1 countries plus Korea, Japan, and China. NAFTA bloc consists of U.S. and Canada. EEC1 consists of Germany, Italy, UK, Netherlands, Spain, Belgium, France and Denmark, whereas EEC2 consists of EEC1 plus Brazil. Second, hypothetical trading blocs among Bangladesh and ASEAN1, ASEAN2, NAFTA, EEC1 and EEC2 countries are constructed to examine the likely effects of such groupings if they were to materialise. Third, a term for each grouping is added in order to capture trade-diversion effects. These terms are indicated by a suffix "N", standing for trade with non-members of the grouping in question. Table 26 presents the correlation matrix of variables and all trade blocs for the year 1994.

Table 27 presents the regression results for the year 1994. To check the robustness of these results, three regression runs are conducted: first, with the existing and hypothesised trading bloc countries; second, with existing trading bloc countries; finally, with the hypothesised trading bloc countries.

This study has 27 countries in its data sample, so that there are 351 data points $[(27*26)/2]$ for a given year. All three standard gravity variables (GDP, GDP per capita and distance) are found to be highly significant statistically at the 1% level of significance. While the BORDER variable retains its sign, it is not statistically significant. All variables except GDP PER CAPITA have their expected signs. The unexpected negative sign for GDP per capita variable suggests that as the GDP per capita of a country improves, it trades less with its bloc members. While this result may be plausible with the members of SAARC countries because most of them have similar per capita income, it is not conceivable why it may be so with other trading partners.

The dependent variable in all regressions is the value of trade (imports plus exports), in log form, between pairs of countries. The estimated

coefficient on the log of the product of the two countries' GDPs at about 0.63 indicates that trade increases with size but less than proportionately. This reflects the fact that small countries tend to be more dependent on trade than larger, more diversified ones. The estimated coefficient on the product of per capita GDPs is about -0.70, indicating that poorer countries trade less with each other. The coefficient on the log of distance is about -0.6, indicating that when distance between two nonadjacent countries is higher by 1%, trade between them falls by 0.60%. The coefficient on adjacency, at 0.44, indicates that two countries sharing a common border trade roughly one and a half times as much [$\exp(.44) = 1.55$] as two otherwise similar countries.

If there were nothing to the notion of trade blocs, these basic variables would soak up most of the variation in bilateral trade flows, leaving little to attribute to a dummy variable indicating whether two countries are members of the same regional grouping. Variations in intra-regional trade would be due solely to the proximity of countries and their rates of economic growth. In fact, the dummy variable for membership in the same regional grouping SAARC is not statistically significant. The SAARC1 and SAARC2 dummy variables are statistically insignificant, indicating the preferential trading agreements among these countries did not yield trade creation benefits. If two countries are SAARC1, for example, they would trade 92% less among themselves than two otherwise-similar countries would [$\exp(-2.59)=0.08$]. Not only that the grouping among SAARC1 bloc (Bangladesh, India, Nepal and Bhutan) indicates a significant trade diversion effect: members of SAARC1 trade 83 per cent less with non-members than do typical countries in this sample [$\exp(-1.78)=0.17$]. Similar results prevail for SAARC2 countries. Although SAARC was formed as a regional cooperation organisation, it is yet to achieve the greater benefits of trade among themselves.

The estimated coefficients of ASEAN1, ASEAN2 and EEC2 dummy variables are not statistically significant. However, the bloc dummy NAFTA and EEC1 are statistically significant. For example, if two countries were members of the EEC1, they would trade more than one hundred and six times as much in 1994 as would two otherwise-similar countries. Members of EEC1 would trade eight times more with non-members than would typical countries in this sample [$\exp(2.063)=7.87$].

The dummy variables of hypothesised blocs--BANASEAN1, BANASEAN2, BANNAFTA, BANEEC1 and BANEEC2--are, however,

neither trade creating nor trade diverting. In summary, the 1994 cross section results point to the conclusion that the regional trade arrangements among the SAARC countries were neither trade creating nor trade diverting.

5.4. Identification of potentially tradable products among the SAARC countries

An attempt has been made to identify tradable products which have the potential to enhance intra-SAARC trade. The list of potentially tradable products is, however, by no means exhaustive. With economic growth, more products will enter into inter-regional trade while better information would also expand trade.

In identifying tradable products, Khan and Mahmood (1993) adopted a two-stage methodology. In the first stage, they list all the tradable products (for both exports and imports) of each country. This represents the maximum possible potential of trade expansion in the region. However, it is possible that in this approach a country, say, A, will list all the products that might be imported from countries B to Z, but those items do not appear in the export list of countries B to Z. To the extent that the import list of country A does not match with the export list of countries B to G the trade potential is reduced. Hence, in the second stage, they identify only those products which appear in the import list of country A as well as in the export list of the other countries of the region. That is, they identify the intersection of these two sets of information. The list of such tradable products (for both exports and imports) of Bangladesh and its SAARC trading partners is given in Table 28.

The products identified in Table 28 are potentially tradable and reflect the resource endowment of the region. A cursory look at the table should make it clear that the products identified as potentially tradable consist chiefly of foodstuffs, industrial raw materials and semi-manufactured goods, including some capital and intermediate goods. A country-wise list of products reveals the structure of production and the level of technology in each country of the region. India's exports to the region are relatively well-diversified consisting of primary as well as manufactured and capital goods. This is clearly a reflection of India's relatively advanced industrial base.

6. POLICY RECOMMENDATION FOR FOREIGN TRADE WITH INDIA AND SAARC COUNTRIES

The low level of intra-regional trade in South Asia partly reflects the similarity of the comparative advantage pattern within the region and also the structural rigidities created by political constraints. The competitive nature of the SAARC economies suggests that mere removal of trade barriers is not likely to have a significant impact on intra-regional trade. Efficient expansion of regional trade is likely to be based on a planned re-organisation of the industrial structure which can create horizontal and vertical complementarities as well as generate scale economies.

The economies of the SAARC countries are similar in factor endowments and cost structure. Therefore, inter-industry trade based on comparative advantage is unlikely to be significant in the SAARC countries. The modern theory of international trade suggests that countries with similar patterns of demand are likely to trade more among themselves because goods, which have achieved economies of scale, can be sold more easily in another country having a similar preference pattern. Therefore, economies of scale can trigger profitable trade flows even in the absence of comparative advantage.

Expanded regional markets within the SAARC should make it possible for many consumer good industries to achieve significant scale economies thus boosting regional trade. However, to the extent that the region's comparative advantage is going to lie in the production of relatively simple consumer goods, an effective market for them must be ensured. This calls for a policy of diverting purchasing power to the relatively poorer segments of the population. Success of the SAARC in this direction is clearly linked to an egalitarian development policy in the region.

In addition to the horizontal integration of the regional consumer goods industry, intra-regional trade can also be increased through vertical integration. Typically, raw materials such as jute, cotton, leather, food, and minerals pass through several stages of fabrication. The essence of vertical integration is to allow one country to specialise in one stage of production of the final commodity thereby realising the economies of scale associated with the particular stage of production.

The level of intra-regional investment by the SAARC countries has been very low. India is the major foreign investor within the region. There are several reasons for the low level of intra-SAARC investment. First, there are three major determinants of foreign investments in developing countries: the size of the domestic market, avoidance of anticipated tariff barriers, and the access to markets in the host country's regions. Except for India, the small size of the domestic markets in the SAARC region offers little prospect for efficient scale of operation and hence profitability. Coupled with this issue is the low per capita income in these countries, which discourages foreign investment exclusively for the purpose of serving the domestic markets.

The SAARC countries compete with each other for similar types of foreign investment. The SAARC countries, with the possible exception of India, have inherited the most labour-intensive production processes while the Pacific Rim countries moved on to production of goods that require more skilled labour and capital. In earlier stages, production utilising relatively labour-intensive technologies moved to the Pacific Rim countries from the developed countries after they switched to the second or third generation technologies. The relatively cheap labour cost is still a major incentive for investment in the SAARC region countries.

There is also a lack of investible surplus in the private sector in the SAARC countries. The growth of intra-SAARC investment can take place if the scope of the market is regional. Another reason may be the efficiency in the scale of plants set up by the consolidation of the production of competing products. These products could be for regional production as well as for export. The major impetus for the growth of foreign investment in the SAARC countries within the region has to come from India, the dominant economic entity within the region. India's current state of industrial development, as well as its technical and manpower capabilities could serve as resources for the whole region.

The SAARC countries can increase financial cooperation among themselves via clearing union arrangements, export credits and payments unions. The lack of internally generated foreign exchange in many of the SAARC countries mean that most of the funds needed to finance imports must be obtained abroad. Often the financing is in terms of development assistance or export credits made available by the developed countries.

While this type of concessionary financing increases north-south trade, it does not provide any assistance in intra-SAARC trade. Increased financial assistance among SAARC countries may be able to achieve the later.

The international inconvertibility of the currencies of the member countries hinders trade. Since payments for trade (between the currencies) generally have to be made in convertible currencies, their own currencies are of little use. However, the provision of convertible currencies runs up against the foreign exchange constraint faced by the SAARC countries. The operational issue is then to devise financial arrangements that facilitate greater trade and investment linkages and in the process circumvent the need for convertible currencies. Three such arrangements are: clearing unions, export credits and payments unions.

The Asian Clearing Union (ACU) already exists and could be strengthened. Of the SAARC countries, Bangladesh, India, Nepal, Pakistan and Sri Lanka are members of this Union. Including the Maldives and Bhutan could enlarge the scope of the ACU. In 1992 about 30% of trade among these countries were transacted through the ACU. This figure can be improved upon with better cooperation among these countries. Another financing option to increase trade could be the provision of export credits by the SAARC countries. India provides short-term export credits only allowing the exporters to obtain local currency payments while waiting for payment in convertible currency. This type of arrangement is efficient if proceeds from export earnings are used to purchase goods from the importing country. Otherwise, the importing country is once again faced with the prospect of obtaining convertible currency. Finally, payments unions can also facilitate trade among the SAARC countries. A payments union envisages the setting up of a fund that will be used to provide medium-term balance of payments credit to the subscribing countries.

Any financial arrangement, however, among the SAARC countries will be limited by the non-convertibility of the currency of the member countries and the region's chronic (convertible) foreign exchange shortage. The success of arrangements such as export credit facilities, the ACU and payments union will depend on the participation of multilateral institutions such as the ADB or the World Bank, particularly in providing access to convertible currencies. An alternative route could be a willingness on the

part of the trade surplus countries to accept non-convertible currencies as payment.

7. SUMMARY AND CONCLUSIONS

A striking feature of the SAARC economies is that the volume of intra-regional trade is very low and the dependence on the industrialised countries is considerable. To the extent that regional trade is limited by the absence of complementarity in production and resource base and financing difficulties, immediate benefits from trade creation within SAARC are not likely to be significant. However, trade in the region is also inhibited by structural rigidities created by political conflicts. Removal of such rigidities under the SAARC can open up some profitable intra-regional trade channels. In the long run, structural change through regional planning can create new vertical and horizontal linkages to generate dynamic benefits from integration. In addition, there is room for mutually profitable cooperation within the SAARC in the areas of trade cooperation in external markets and regional water management with regard to the problems of floods and irrigation. A precondition for successful integration among the SAARC countries is a diffusion of political tensions so that regional complementarities and scale economies can be exploited and, at the same time, mutually agreeable mechanisms for equitable distribution of benefits and costs of integration can be put in place.

The Government of Bangladesh needs to implement a number of measures to increase trade and promote economic growth. A conscious government policy is needed to attract investment, both domestic and foreign, with a view to encouraging capacity building, and improving productivity and competitiveness in terms of both quality and cost. The problem of low labour productivity and hence of high relative wage costs of exports should be solved. Bangladesh is a low-wage country, but in terms of productivity, Bangladesh's labour is among the costliest in the world. Only skill development and infusion of better technology, not devaluation, can remedy this problem.

All structural impediments to export expansion must be removed. The preconditions for successful export promotion are superior product quality, availability of sound physical, social and economic infrastructure, adequate institutional facilities for banking, credit and

insurance, freedom from labour unrest and congenial labour-management relations, improved law and order situation, an honest and efficient administration responsible for implementation of the export development programme, and above all, continuous political stability in the country.

A major problem with the country's export trade is the narrow export base, and also concentration of exports in a few developed country markets. Government policy should encourage diversification of the export base by providing selective incentives, if necessary, by "picking the winners" as the East Asian countries did. At the same time new markets should be explored. There is no reason why Bangladeshi exporters and the institutions responsible for export promotion should not keep an eye on the fast-growing markets outside the developed Western countries.

There is the need for reviewing the existing incentive structure in the export sector. Despite the wide array of explicit policy instruments used to promote exports, export activities seem to remain less profitable than commerce or other activities. The usefulness of existing measures on promoting non-traditional exports also remains limited to some specific industries, e.g., RMG and leather. Also, current promotional policies do not encourage backward integration of export industries, although it is necessary for increasing domestic value added and net export earnings. To overcome these shortcomings, there is the need for devising new measures or new instruments which will be easy to implement and respond quickly to the rapidly changing needs of the export sector. In order to reduce the huge trade deficit with India, Bangladesh should, among other things, devalue its currency further, stop border smuggling, seek reduction in tariff and non-tariff barriers on Bangladeshi exports to India, encourage more Indian investment in Bangladesh and make the SAPTA more meaningful and operational.

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