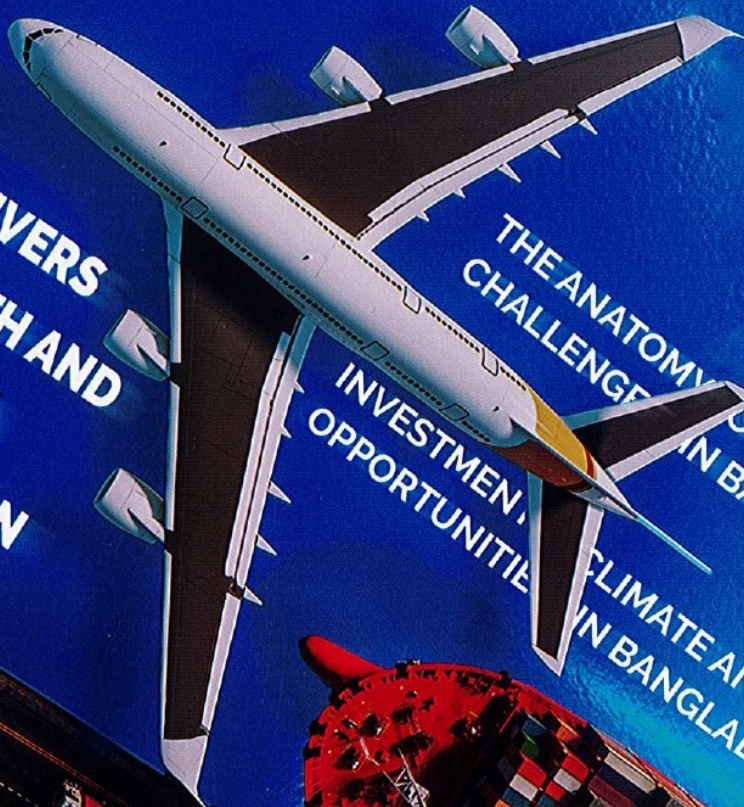
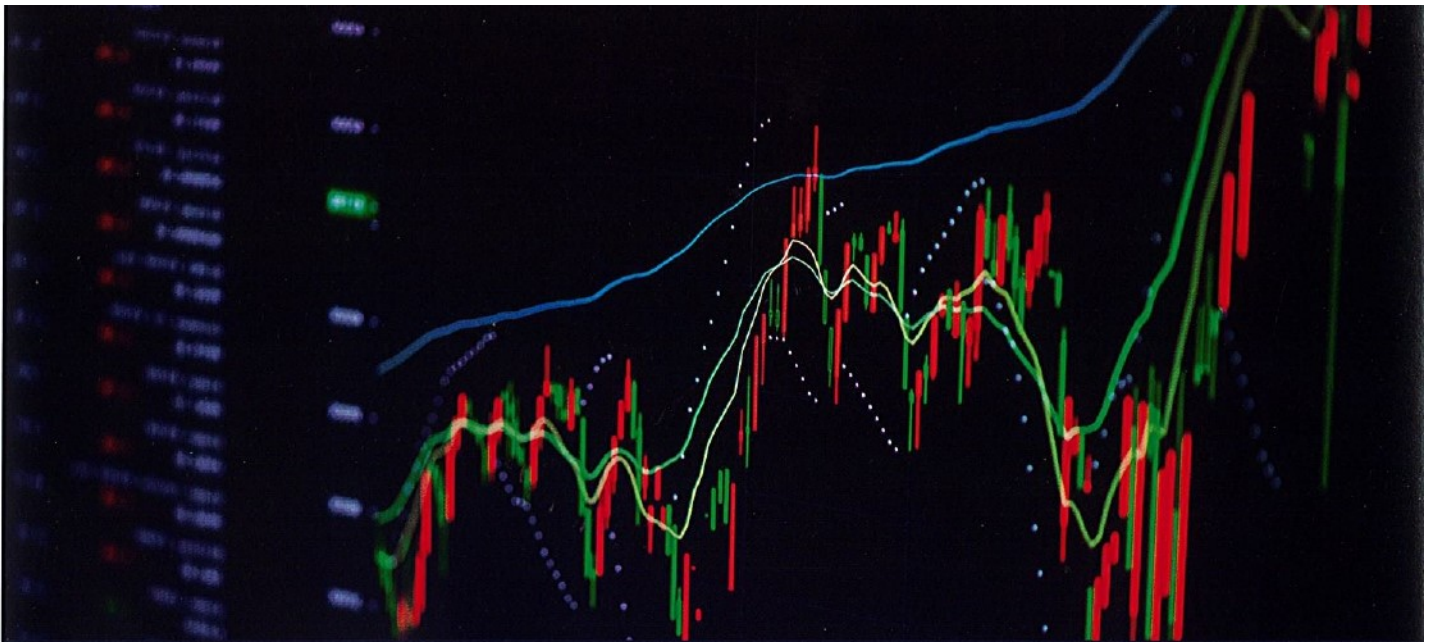


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UNDERLYING DRIVERS
OF EXPORT GROWTH AND
THE NEED TO DEEPEN
REGIONAL COOPERATION

THE ANATOMY OF MACROECONOMIC
CHALLENGES IN BANGLADESH
INVESTMENT, CLIMATE AND
OPPORTUNITIES IN BANGLADESH





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UNDERLYING DRIVERS OF EXPORT GROWTH AND THE NEED TO DEEPEN REGIONAL COOPERATION

Introduction

Bangladesh's export sector performance in the outgoing FY2021-22 has been quite impressive by any measure: compared to FY2020-21 when Bangladesh's global export was USD 38.76 billion, export earnings in FY2021-22 stood at USD 52.08 billion, a robust growth of 34.4 per cent. Understandably, exports of readymade garments (RMG) played a key role here since the sector accounts for about 81.0 per cent of total export of the country. Export of RMG was USD 42.6 billion in FY2021-22, posting a growth of 35.5 per cent over the preceding year. This record is truly remarkable and is a testimony to Bangladesh's competitive strength in the global apparels market which the country was able to gradually build over the past years. However, the

underlying nature and drivers of the recent growth performance merits careful consideration and closer scrutiny.

Underlying Drivers of Export Growth

In view of the above, a distinction should be made between gross export and net export earnings since the issue of domestic value retention is critically important from the perspective of actual foreign exchange earnings and forex reserves implications of the RMG exports. In this backdrop, evidence bears out two important features: firstly, Bangladesh's net export earnings from RMG export is significantly lower than gross export earnings; and secondly, and this is encouraging, the share of net exports has been on the rise in the recent past years.

Broadly speaking, Bangladesh RMG exports can be grouped under two categories: Knit-RMG and Woven-RMG.

Traditionally woven-RMG used to be the dominant segment within the RMG

industry. However, its share has experienced a secular decline over the past years. While there has been some investment in backward linkage activities, a significant share of yarn and fabrics has to be imported from the global market. On the other hand, over the years Bangladesh's knitwear sector has gained in strength thanks to its strong backward linkage in spinning, weaving, garmenting and dyeing-printing. Its share in RMG exports has gone up from 18.0 per cent in late 1990s to 54.0 per cent in very recent times. To note, domestic value retention is higher for knitwear, at about 75.0 per cent of the gross export earnings, according to our estimates, compared to woven-wear for which the corresponding share is about 55.0 per cent. A quick calculation based on the above would show that the domestic value addition in RMG exports would be about 65.0 per cent of gross export earnings. This reinforces the need for strengthening backward linkages in RMG particularly in the woven-RMG segment in order to increase domestic value retention. The other factor to consider is that

two-thirds of Bangladesh's RMG export is cotton-based. To compare, two-thirds of the global apparels market is at present based on manmade fibres; and this share has been on the rise in recent years. Production and export of manmade fibre-based RMG needs to be incentivised and accelerated to ensure that export-oriented RMG sector has a strong foothold in this growing component of the global market. This will also enhance domestic value retention capacity of the sector. Intra-RMG diversification and ability to move up the demand curve, into more design and fashion based segment (as against mass-produced items), have important positive implications not only for product and market diversification but also for value retention.

The other factor to consider in view of value retention is the nature of the export earnings growth – whether the growth is price-driven or volume-driven. The price of cotton, the key raw material, has risen significantly, by about 50.0 per cent, over the past one year. Consequently, the prices of intermediate items such as yarn and fabrics have also risen in tandem. To note, cotton accounts for about 20-25 per cent of production cost of an RMG item on average (however, as would be understood, the share varies quite significantly depending on the particular item). Thus, it is important to keep in mind the relative contribution of factors contributing to the growth of export earnings from the RMG: increase in prices, increase in volume or both, and if the last be the case, what is the relative contribution of price increase and volume increase to the increase in export earnings.

Our estimates show that the high export growth, both in the EU and the US markets, was driven primarily by volume rather than price. If the fact of the significant rise in the prices of raw materials and intermediate inputs, noted above, is taken into cognisance, this would imply that buyers and brands have been able to pass on a large part of the burden of rising prices to the exporters and suppliers of RMG

products. Our estimates show that if Bangladesh's RMG export growth of 47.4 per cent in the US market (during the first nine months of FY2021-22) is decomposed, it would be seen that average price per unit had risen by only 6.5 per cent against the growth in volume of 36.5 per cent. In the EU, over the same period, RMG export earnings have risen by 33.2 per cent, with the corresponding growth of 10.7 per cent (price) and 20.3 per cent (volume). It will be pertinent to mention that these two markets together account for 70.0 per cent of Bangladesh's RMG export. This feature (volume-driven rather than price-driven) was relatively more pronounced in case of woven-RMG where weak backward linkage could imply relatively weak bargaining power of exporters.

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The above once again reinforces the argument for further strengthening backward linkage in the RMG sector. The issue of going into forward linkages should also not be ignored. The global trade in apparels is a buyer-driven value chain, meaning the trade has traditionally been dominated by global brands and buyers. Time has come for Bangladesh's leading RMG entrepreneurs and exporters to go for forward linkage activities by linking directly with the retail segment of the value chain. The aspiration, and the target, should be to put Brand Bangladesh on the global RMG scene.

Regional Cooperation and Deepening Trade Ties with Malaysia

Yet another weakness of Bangladesh's RMG has been its weak linkage with the regional markets. In view of significant preference erosion originating from Bangladesh's LDC graduation, serious attention should be accorded to accessing these markets. Initiatives to promote the cause of market and export diversification ought to be prioritised in Bangladesh's strategy for sustainable LDC graduation. As was noted, Bangladesh's exports are predominantly destined for the EU and North American markets. South Asia, East Asia and ASEAN region together account for only about 12.0 per cent of Bangladesh's exports. This pattern is also evident in case of apparels. True, there are 11 countries where exports of Bangladesh's RMG have exceeded USD 1.0 billion in FY2021-22. However, excepting Japan, all these countries belong to either the EU or the North American region. Also, technological intensiveness of Bangladesh's exports is way lower compared to, for example, competitors such as Vietnam. As a recent study by the author indicates, 95.1 per cent of Bangladesh's exports are of low technology intensiveness compared to 30.7 per cent for Vietnam. Diversification away from low technology-intensive items has remained a key challenge for Bangladesh. On the other hand, neighbouring regions such as the ASEAN and East Asia have emerged as major importers of apparels in recent times. Triangulation of transport connectivity, investment connectivity and trade connectivity will be crucially important in realising the potential opportunities of market diversification in this context. Also, Bangladesh should proactively explore opportunities of signing Free Trade Agreement (FTA) and Comprehensive Economic Partnership Agreement (CEPA) with ASEAN, RCEP, and other groupings and countries in the region. To alert, however, such regional trading arrangements will call

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for a high degree of reciprocity and Bangladesh will need to take adequate preparations for undertaking the needed reforms and pursuing tough negotiations.

Deepening of opportunities of bilateral trade and economic cooperation should also be explored more proactively. Bilateral trade relationship with Malaysia could serve as a pertinent example here. Bangladesh's exports to Malaysia which was only USD 26.7 million in 2005, went up to USD 145.7 million in 2010 and to USD 207.7 million in 2015. In 2021 exports stood at USD 313.8 million. Imports have also risen in tandem – in 2015 this was USD 1004.2 million which went up to USD 2259.1 million in 2021. Thus, in 2021, Bangladesh's trade deficit with Malaysia stood at about USD 1945.3 million.

An analysis of the import duties imposed on top ten items of export of Bangladesh to Malaysia (interestingly all top ten items in 2019 are found to be apparels items barring export of potato) shows that the MFN import duties on all these items are zero. Thus, Bangladesh's LDC graduation will not likely have any significant tariff implications for almost all items of export to Malaysia as the question of preferential access did not arise in the first place. On the other hand, if export potentials are estimated, one finds that even from a static (taking into

consideration the current export structure) perspective there are good opportunities to enhance exports of apparels to Malaysia. An estimate of untapped potentials, based on Export Potential Map exercise indicates that export earnings from top ten items of export to Malaysia may be doubled if Bangladesh's competitive strength could be raised. On the other hand, of the top imported items from Malaysia seven faced import duties in Bangladesh, to varying degrees. Discussion as regards any bilateral preferential trade agreement with Malaysia will need to take this trade structure into account as duty-free market access will entail significant revenue loss for Bangladesh. At the same time Bangladesh should explore why items which are produced in Bangladesh and exported to the global market are not being exported to Malaysia although Malaysia imports those same items from the global market. Bangladesh should also identify which items in the import basket of Malaysia should be targetted for purposes of export to the Malaysian market.

Till now, barring the telecommunication sector, Malaysia's FDI in Bangladesh has not been significant: As of December, 2021, the country's FDI stock in Bangladesh was USD 794.4 million of which about USD 705.7 million (almost 88.0 per cent) was in telecommunication sector. To note, Bangladesh's total FDI stock in December, 2021 was about USD 21.6 billion. In 2021 gross FDI flow to Bangladesh from Malaysia was about USD 65.9 million, of which USD 48.5 (about 74.0 per cent) was in telecommunication sector. Bangladesh's gross FDI flow in 2021 was about USD 3883.3 million. Attracting investment from Malaysia, particularly in the special economic zones (SEZs), targetting the Malaysian market, should be the strategy here.

On the other hand, overseas employment in Malaysia and remittance flows from the country have emerged as prominent features in the bilateral economic relations involving these two countries.

Remittance flow to Bangladesh from Malaysia rose from USD 587.2 million in FY 2009-10 to USD 1381.7 million in FY2019-20 and USD 2002.4 million in FY2020-21 (which was about 10.0 per cent of Bangladesh total remittance flow in that year, a significantly high number). The number of workers leaving for jobs in Malaysia has experienced high volatility in the recent past years, for various reasons – the number was the highest (273.2 thousand) in 2007. In 2017 and 2018 the corresponding numbers were 99.8 thousand and 175.9 thousand. However, in 2019 the number was less than one thousand. Indeed, during the Covid time a large number of these workers were forced to return to Bangladesh from Malaysia; many are still struggling to go back and rejoin their jobs. The reasons are many and merits separate discussion, but only to add that there is an urgent need to streamline the relevant procedures and policies to get the matter back on track so that migration of Bangladeshi workers to Malaysia can resume in full earnest.

Concluding Remarks

LDC graduation will have important implications for Bangladesh since the country will lose many of the LDC-specific international support measures (ISMs) in 2026 or within a few years thereafter. Bangladesh should incentivise intra-RMG diversification and encourage higher domestic value retention from export of apparels, through backward and forward linkage activities. Deepening of regional cooperation through Comprehensive Economic Partnership Agreements (CEPAs) and closer ties with countries in the neighbourhood such as Malaysia should be seen as a key element of Bangladesh's sustainable LDC graduation strategy and its journey ahead in the twenty first century.

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