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Accessing the Growing Import Market of China

Strategies to Realise Potential Opportunities*

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Highlights

- The increasingly large trade deficit with China has emerged as a major concern for Bangladesh.
- Recently, China has indicated its interest in establishing a bilateral FTA with Bangladesh, preferably by 2026.
- In order to establish strategic ties with China, Bangladesh should first identify its offensive and defensive interests, carefully weigh revenue loss implications, desired rules of origin, and avenues of attracting Chinese investment in Bangladesh.
- Based on analysis, the study argues that Bangladesh has significant export potentials in the Chinese market.
- Bangladesh should stimulate and incentivise technology and know-how transfer from China and explore the potential opportunities of currency co-operation with the country.

THE CONTEXT

The policy brief focuses on Bangladesh-China trade ties to identify opportunities of expanding Bangladesh's exports to the growing import market of China. The paper argues that Bangladesh ought to seize the opportunities offered by the growing import market of China, which it has failed to do till now. While China continues to remain Bangladesh's foremost bilateral trading partner, the increasingly large trade deficit with the country has emerged as a major concern for Bangladesh in recent times. Particularly in view of the country's LDC graduation, with consequent loss of preferences and the resultant erosion competitive strength, exploration of new export opportunities has assumed heightened importance for Bangladesh. It is in this backdrop that an in-depth investigation into export opportunities in the Chinese market demands urgent attention on the part of Bangladesh's policymakers. In recent times, China has also indicated its interest in establishing a bilateral FTA with Bangladesh, preferably by 2026. Issues of Bangladesh's export potentials in the Chinese market and the proposal of the bilateral FTA with China demand careful examination by Bangladesh's competent authorities.

It is to be noted that in the recent past years, China's involvement in Bangladesh has branched out beyond trade into investment, lending, infrastructure building and construction, student and cultural exchanges, as also political visits at the highest levels. The visit of the Prime Minister of Bangladesh to China in June 2014 and July 2019, and that of President of China Xi Jinping to Bangladesh in October 2016, were key milestones in advancing the bilateral ties. The visits consolidated the geo-economic and geo-strategic ties that underlie the relationship between the two countries and underpin the subsequent initiatives at deepening the ties between the two countries.

During his visit, President Xi in his remarks stated, 'We agreed to elevate China-Bangladesh ties from a comprehensive partnership of cooperation to a strategic partnership'. Prime Minister Shiekh Hasina,

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* The Policy Brief presents key findings of a recent study undertaken by the CPD titled 'Getting Into the Chinese Market: A Window of Opportunity for Bangladesh', (CPD, 2023).

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on her part, observed, ‘Bangladesh is willing to actively work with China within the framework of the BRI and support building of an Economic corridor linking the BCIM (Bangladesh-China-India-Myanmar) so as to push forward development in various fields such as investment, agriculture, transport infrastructure and connectivity’.

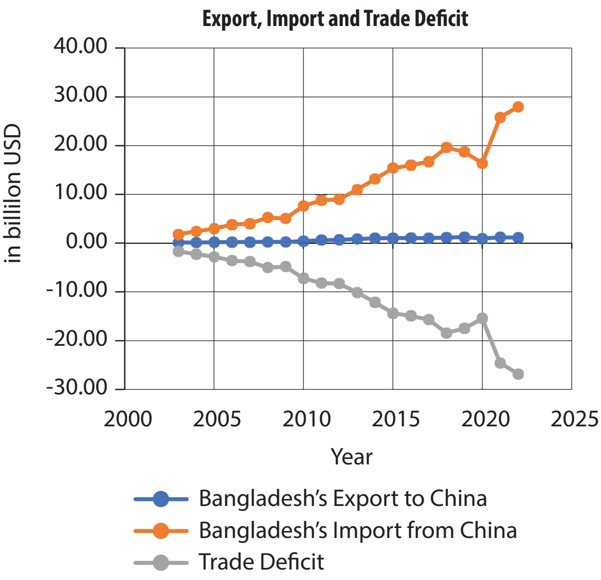
The deals signed during President Xi’s visit to Dhaka included both Government to Government (G2G) and Business to Business (B2B) projects and initiatives, worth about USD 25.0 billion and USD 15.0 billion respectively. These were envisaged to be implemented over the next five years. These projects were related to building various infrastructure projects in Bangladesh, establishment of Chinese enterprises in dedicated economic zones, defence co-operation and lending on soft terms. Many of these projects were geared to strengthening export-related capacities of Bangladesh through the triangulation of transport, investment, and trade connectivities.

As the foremost import source of Bangladesh, China’s importance as a trading partner cannot be overemphasised. On the other part, in spite of the preferential market access for almost all items of export originating from Bangladesh which was offered by China, the country has not been able to make any mentionable entry into the growing import market of China[1]. Indeed, the bilateral trade deficit has been rising exponentially in recent years. The Policy Brief argues that Bangladesh could learn from the experience of Vietnam which was able to increase its exports to China significantly over the past decade, from USD 16.6 billion in 2015 to USD 57.7 billion in 2022.

KEY FEATURES OF SINO-BANGLADESH TIES

The value of total trade between Bangladesh and China was about USD 29.1 billion in 2022. While the share of Bangladesh’s exports to China was 1.9 per cent of her global exports in 2022, according to ITC database, the corresponding import share is found to be 42.6 per cent. However, according to the Bangladesh Bank data, the two corresponding shares are found to be 1.74 per cent (for FY2021-22) and 24.9 per cent (FY2022-23)[2]. According to ITC data, in 2022, imports from China were USD 28.0 billion, as against exports of only USD 1.13 billion[3]. To note, China replaced India as Bangladesh’s most important bilateral trading partner in the early 2010s.

Figure 1 **Bangladesh’s Export, Import and Trade Deficit Vis-a-vis China**



Source: Extracted from ITC Trademap, (2023).

As the table indicates, Bangladesh has a large trade deficit with China. It is true that in a globalised world, it is not the bilateral trade deficit but the global trade balance that should concern countries. Imports of RMG raw materials and intermediate as also machineries from China help Bangladesh’s export oriented RMG industry to remain competitive in the production of apparels, which in turn enables Bangladesh to export more apparels to the US with which Bangladesh has a significant trade surplus (of about USD 10.0 billion). This is, however, not to say that enhancing exports to China is not an

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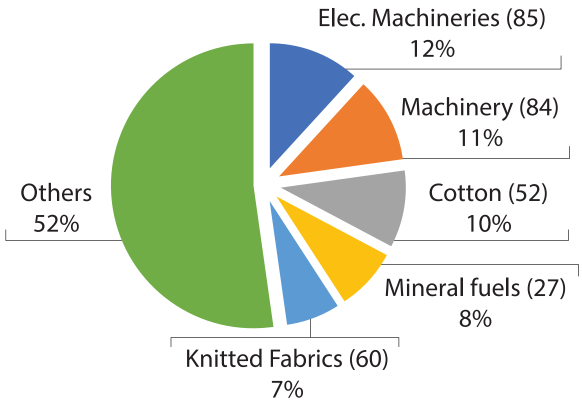
[1] The total number of export items from Bangladesh was only 554 as against 3,449 items of import from China to Bangladesh (at 6-digit level).

[2] Trade data in the Policy Brief are sourced from ITC. Import and Export data which are collected from relevant sources in Bangladesh (Bangladesh Bank and EPB respectively) differ (are significantly lower than) from that in the ITC data. Similar was the case with Ministry of Finance (MoF) data. For example, Bangladesh’s import data for China (for 2022) in ITC is USD 26.8 billion, whereas the BB and MoF figures for FY21-22 was USD 19.3 billion and USD 24.3 billion respectively. This issue of data discrepancy merits separate investigation.

[3] Data and information for China includes relevant correlates for both China and Hong Kong.

Figure 2 **Bangladesh's Top-5 Imports from China in 2022**



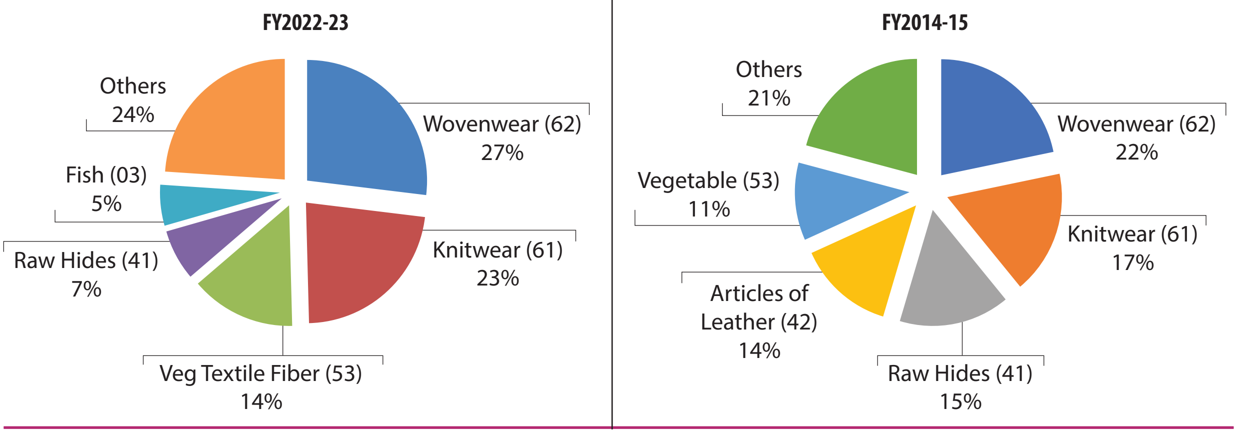
Source: Authors' estimation based on ITC Trademap, (2023).

important issue. Indeed, Bangladesh should explore all possible avenues to reduce the bilateral trade deficit with China through higher export earnings.

A decomposition of Bangladesh's exports to China does not show any discernible change over the last decade, between FY2014-15 and FY2022-23. The top five exports have remained more or less the same: woven wear, knitwear, raw hides and vegetables, with fish and crustaceans replacing raw hides during this period. This high concentration of exports (at two-digit level) is corroborated by the shares of top 5 items in FY2014-15 and FY2022-23, which stood at 79.0 per cent and 76.0 per cent, respectively.

As is known, Bangladesh is the world's second-largest exporter of apparels, with China being the first[4]. Even in the particular case of China, Bangladesh's export basket could not avoid being dominated by apparels (apparels constituted about 50 per cent of total exports in FY2022-23. On the other hand, imports from China are way more diversified. A decomposition of the imports indicates that these import items mainly constituted machineries, electric machines, various equipments, etc. (23 per cent), fuel and apparels (25.0 per cent). Indeed, Readymade Garments (RMG)-related imports such as cotton and fabrics help Bangladesh to maintain a healthy surplus (of about USD 10.0 billion) with the USA. Chinese imports are beneficial to Bangladesh from the perspective of consumer welfare, export competitiveness and labour and capital productivity gains. Thus, the bilateral trade deficit needs to be seen from a broader macro-economic vantage point. However, as was pointed out earlier, the challenge facing Bangladesh is to get into the growing import market of China through building of supply side capacity building export diversification and raising competitive strength.

Figure 3 **Bangladesh's Top 5 Exports to China: FY2014-15 and FY2022-23**



Source: Authors' estimation based on EPB, (2023).
Note: HS codes of the items are indicated in parentheses.

[4]The respective shares in the global apparels market are about 7.9 per cent and 31.7 per cent.

FDI Flow and Borrowings

In recent times, share of China in Bangladesh's inward FDI flow has seen some increase. In 2022, FDI from China (including Hong Kong) stood at USD 764.0 million, about 15.8 per cent of total inward FDI flow to Bangladesh for the corresponding year. Chinese FDI was mostly dominated by Textile and Wearing (47.6 per cent) and Power Sector (33.2 per cent).

Over the past few years, China has emerged as a major source of borrowings for Bangladesh. The Chinese loans are of two types: ODA (overseas development assistance) and suppliers'/buyers' type of credit. These loans underwrite finances for the establishment of transport links and connectivity, setting up production units, providing various services including provision of water and sanitation, setting up ICT networks, building power units and for purposes of government procurement. An assessment of Chinese lending scenarios indicate the followings: (a) Chinese loans are semi concessional (2.0 per cent per annum)[5] (b) grace period is shorter (on average 5 years); (c) repayment period is lower (on average 15 years); and (d) there is a service charge attached.

Bangladesh's exposure to Chinese credit, both public and private, has been on the rise in recent years. Higher export to China is also important from the perspective of not only underwriting the growing Chinese imports, but also from the point of servicing the rising debt to China.

OPPORTUNITIES TO ENHANCE BANGLADESH'S EXPORTS TO CHINA

As was noted earlier, given Bangladesh's apparels-dominated export, it is extremely difficult to get into the Chinese market with current export structure. One would hardly expect these two countries to trade heavily in RMG products. An analysis of the dynamics of Bangladesh's exports to China indicates a large amount of volatility. In case of a number of products, Bangladesh is not being able to hold on to in the Chinese market after having made some initial inroads. One finds that between FY2012 and FY2017 Bangladesh's exports have experienced notable rise, albeit from a very low base. However, between then and now there has been a significant overall decline in exports to China, as also for all the major items.

On the other hand, our analysis indicates a number of products which Bangladesh exported to the world but not to China, while China imported these products from the world but not from Bangladesh. The above would imply that Bangladesh did have the supply-side capacities in producing these items and is currently exporting those items to other countries but not to China. To realise the potential opportunities, Bangladesh will need to put in place and enhance supply-side capacities, raise labour and capital productivity and reduce lead time, to be able to translate its *comparative advantages into competitive advantage* in the Chinese market.

Export product diversification, through strengthening of backward and forward linkages, will be crucial in view of the above. It is here that the FDI could play an important role. As of now, Bangladesh's backward linkages are very weak excepting in case of RMG; forward linkages also remain rather underdeveloped. Developing regional and sub-regional value chains and production networks could help create the supply side capacities towards competitive entry into Chinese market.

The *ITC Export Potential Map* allows an estimation of one country's export potential with respect to another country. The tool helps to come to an estimation as regards Bangladesh's export potentials in various items in the Chinese markets. The tool compares export potential with actual export and identifies Bangladesh's unrealised export potentials in the Chinese market. As the results indicate (Table 1), there are significant unrealised export potentials in the Chinese market for a number of items of export from Bangladesh, including apparels, fish and shellfish, footwear items, manufactured products, etc.

[5] These were lower than those provided, for example by the World Bank's IDA window. However, these are still concessional in the sense that the interest rates are below the commercial (market) rates.

Table 1	Export Potential of Bangladesh's Major Sub-Sectors in China *(in million USD)*		
Sectors	**Export Potential**	**Actual Exports**	**Unrealised Potential**
Apparel	1600	469	1200
Flax, hemp and natural fabric n.e.s	153.0	114.0	40.0
Fish and Shellfish	146.0	53.0	101.0
Footwear	120.0	29.0	91.0
Miscellaneous manufactured product	77.0	37.0	44.0
Skins, leather & products thereof	62.0	85.0	9.7
Optical products, watches & medical instruments	22.0	12.0	14.0
Vegetal textile fibres	20.0	16.0	3.4
Cotton (fabric)	17.0	20.0	3.1
Plastics and Rubber	13.0	8.2	8.7

Source: Extracted from ITC Export Potential Map, (2023).

STRATEGIES AND OPTIONS FOR DEEPENING BILATERAL ECONOMIC TIES

This section identifies some of the initiatives Bangladesh could pursue towards deepening of trade relations with China, particularly by exploiting export opportunities in the Chinese Market.

Rationale for FTA with China

In recent times, the idea of an FTA with China has been mooted; the idea is to put in place an FTA by 2026[6]. As is known, this coincides with the timeline of Bangladesh graduating out of the group of LDCs which is scheduled to take place in November 2026.

We have estimated the revenue loss implications of an FTA with China. Since China provides DF-QF market access for almost all exports from Bangladesh, China does not earn any revenue by imposing duties on Bangladesh's imports. The scenario under the FTA remains unchanged for China (no revenue loss). On the other hand, the picture is quite different for Bangladesh. Our estimates, show that Bangladesh is significantly dependent on various duties collected on items of imports from China. The Total Tax Incidence (TTI) on Chinese imports is as high as 58.4 per cent of the import value[7]. Because of the combination of high import duties and the significant amount of imports, there is likely to be substantial revenue loss implications for Bangladesh from an FTA with China.

In view of the above, Bangladesh will need to strategise in a way that reduces its potential revenue losses and increases its potential gains in the form of higher exports originating from the proposed FTA. One strategy for Bangladesh could be to defer the FTA and argue for continuation of the DF-QF market access offered by China beyond 2026 (LDC graduation timeline for

Table 2 Revenue Collected by Bangladesh from Imports from China (2022)

		Import from China (in mln USD)	Revenue from CD (in mln USD)	CD Rev as (%) of Imports	Revenue from TTI (in mln USD)	TTI Rev. as (%) Imports
All Sections	All Imported Products (8 Digit Level)	26198.4	4546.0	17.4	15290.1	58.4
Top-10	Top-10 Imported Products (8 Digit Level)	4906.9	756.1	15.4	2595.4	52.9

Source: Authors' estimation based on ITC Trademap, (2023).
Note: The import data is extracted from ITC Trade Map database, which is based on calendar year 2022. The operative tariff schedule is sourced from Bangladesh's National Board of Revenue, which is based on fiscal year 2022-23.

[6] The Chinese Ambassador, at a meet with diplomatic journalists on November 10, 2023, stated that a feasibility study is currently being carried out to examine the various aspects of establishing a free trade area. This was to be followed by actual negotiation.

[7] The TTI (includes customs duties (CD), supplementary duties (SD), Value Added Tax (VAT), advance income tax (AIT), regulatory duties and advance tax (AT).

Bangladesh). The EU and UK have already offered such an extension for three years[8]. Also, mention may be made about a recent decision in the WTO to support LDCs on the path to graduation through continuation of the preferential market access. Bangladesh may request to join the initiative. If and when an FTA with China is negotiated, Bangladesh should ask for *less than full reciprocity* in terms of trade liberalisation on grounds of being the relatively weaker partner in view of the significant revenue loss noted above.

Reducing Bangladesh's formidable bilateral trade deficit with China will call for initiatives beyond mere trade liberalisation. It may be advisable to go for a *Comprehensive Economic Partnership Agreement (CEPA)* rather than just an FTA. Any such FTA or RCEP should have flexible rules of origin, safeguard measures (e.g., in view of import surge, compensation for revenue losses, etc.), a two-track trade liberalisation policy, provisions for technology transfer, incentivisation of FDI flows to Bangladesh and other measures to take care of Bangladesh's concerns and advance her interests. Bangladesh should carefully identify its *offensive* and *defensive interests, offer list and request list*, list of sensitive items and the non-negotiables. This will call for evidence-based analysis, appropriate negotiating, strategies and capacities and careful preparation to undertake FTA/RCEP discussions in an informed way.

GAME THEORY APPROACH TO ASSESS FEASIBILITY OF FTA WITH CHINA

We have deployed the game theory approach in order to explore some of the possible outcomes originating from different scenarios of tariff treatment[9]. The *pure strategy Nash equilibrium* is a scenario in a game where each player chooses a strategy that is the best response to the tactics chosen by the other players, and no player can benefit by changing their strategy while the others keep theirs intact. For simplification, we have chosen the Top-10 export items of each country at 6-digit level. For the purposes of simulation, we have used *Trade Intelligence and Negotiation Adviser (TINA)* developed by the UNESCAP.

Based on the above, we constructed a *payoff matrix* reflecting each country's payoff for the respective strategies pursued by both the countries. The payoffs for each country for each scenario are computed on the basis of two impacts: *revenue impact* (positive or negative) and *trade impact* (positive or negative). The impacts of own strategy and the effect of the other players' strategy are captured in the result matrix (Table 3). Cell (d) depicts the scenario when both Bangladesh and China are not imposing tariff on each other which is the Free Trade Agreement scenario. However, as can be seen from the payoff matrix, Bangladesh stands to lose significantly in view of the FTA scenario.

After calculating the payoffs, we get the following results table:

Table 3 **Payoff Matrix for Bangladesh and China**

(in million USD)

Country		China	
		Tariff	No Tariff
Bangladesh	Tariff	-145.5, 20.7 (a)	0, 0 (b)
	No Tariff	-1026.7,2166.7 (c)	-901.9, 2146.0 (d)

Source: CPD Plastic Sector Survey, 2023.

The payoff matrix indicates that of all the four possible scenarios, Cell (b) is the preferred option for Bangladesh (Bangladesh imposes tariff and China does not); this is indeed the current scenario. In all other scenarios, Bangladesh stands to incur losses in terms revenue and adverse trade impacts. Thus, it is not advisable for Bangladesh to go for an FTA based on *full reciprocity*. However, one must concede that from a general equilibrium model perspective, cell (d) could also potentially generate some favourable outcomes (positive externalities in the form of consumers' and producers' welfare and competitive gains from cheaper imports, among others). If other parallel initiatives are also put in place, as indicated earlier, there could be win-win outcomes from a possible FTA. The option of FTA thus should not be discarded altogether. However, as was argued earlier, a two-track trade liberalisation, supported by investment, trade facilitation, technology transfer, concessional loans and other forms of support, within the ambit of a CEPA, may be considered as a possible option.

[8] To recall, China has offered an extension of its unilateral preferential scheme for LDCs (for certain items of exports) to Samoa following the country's graduation from the group of LDCs in 2014.

[9] A pure strategy Nash equilibrium was built for this purpose.

Table 4 Technology-Intensiveness of Manufactured Exports

Manufacture products based on	Bangladesh		Vietnam	
	2010	2021	2010	2021
Natural Resource	4.06%	2.4%	9.23%	7.5%
Low-Technology	89.48%	93.4%	40.70%	29.3%
Medium Technology	1.61%	1.2%	9.16%	12.9%
High Technology	0.42%	0.8%	10.63%	40.7%

Source: Authors' estimation based on Lall, (2000) and UN Comtrade, (2023).

LEARNING FROM VIETNAM

As Vietnam's experience bears out, FDI has helped the country to significantly raise its technological embeddedness of exports. Whilst the *share of low technology-embedded* exports in Bangladesh's total exports stood at 93.4 per cent in 2021 (to note, increasing from 89.5 per cent in 2010, a disquieting development), that of Vietnam experienced a decrease to 29.3 per cent from 40.7 per cent over the corresponding period. On the other hand, the share of medium and high technology exports of Vietnam stood at 53.6 per cent in 2021, registering a significant rise from 19.8 per cent in 2010. In contrast, the two corresponding figures for Bangladesh were 1.1 per cent and 2.0 per cent. Not surprisingly, with a GDP of USD 460 billion (FY2022), share of Bangladesh's global exports (USD 52.0 billion) in the GDP was a lowly 11.3 per cent. While Vietnam's GDP (USD 408.0 billion) was lower than that of Bangladesh, its global exports (USD 370.9 billion) were much higher, equivalent to 90.9 per cent of the GDP. This clearly demonstrates how Vietnam has moved strategically over the past decade in pursuing an export-oriented industrialisation and development strategy. There is a lesson to be learned by Bangladesh from this. As was noted earlier, FDI from China and other countries and value chain linkages with China have played a key role in this.

Attract FDI from China

The preceding analysis has shown that technological embeddedness of Bangladesh's export has been very low. In view of this a key strategy for Bangladesh should be to attract Chinese FDI to Bangladesh that targets the Chinese market, as also other markets. In this context, the Chinese Economic and Industrial Zone (CEIZ) in Anwara Upazila in Chattogram could play a very important role. To recall, a large part of Vietnam's export to China originates from Chinese FDI in Vietnam. The Chinese CEIZ could play a similar role. The recently completed tunnel under the river Karnaphuli[10] will create good connectivity between CEIZ and the Chottogram and Matarbari ports. Industries that could be set up at the CEIZ include chemical industries, automobile assembling, high-end garments, pharmaceuticals, leather and footwear and others. The CEIZ could also potentially be a hub of China's sunset industries.

Underwriting Chinese Imports through Credit Lines

Bangladesh is a significant export market for China, and it is in China's interest that Bangladesh has the capacity to pay for the imports originating from China. Given that, at present, it is experiencing balance of payment problems and forex reserve drawdown, Bangladesh may come to an agreement with China to defer payment for imports through short-term credit arrangements. Such concessional lending could be part of terms of the proposed CEPA.

Yuan as a trading option

The overwhelming share of Bangladesh's trade is intermediated through the US Dollar. On the other hand, in recent times, China has been trying to promote Yuan (Renminbi) as a global reserve currency[11]. Given the current

[10] This is the first of its kind underwater tunnel in South Asia.

[11] As is known, Bangladesh and India have already taken first steps to trade in Indian Rupee, although until today the volume of trading in the Indian Rupee has been rather limited.

shortage of foreign exchange faced by Bangladesh, trading in Yuan is an option that Bangladesh could explore. True, there are several factors which at present constrain the use of Yuan for trading purposes. The most important of these is Bangladesh's limited access to Yuan, given the significantly large bilateral trade deficit (favouring China)[12]. One possible option in this backdrop is to widen the ambit of bilateral BDT-Yuan transactions beyond the limited remit of trade, by including other transactions- borrowings from China, Chinese investment flows to Bangladesh, and other avenues in view of which Yuan needs to be converted to BDT (which is currently being done mostly via intermediation of USD). There can also be an Asian Clearing Union (ACU) type trade settlement involving the countries which are trading with China in Yuan[13]. This way, the bindings of the trade deficit could, to some extent, be overcome. However, there has to be well-crafted and well-planned cooperation between the two central banks, the Bangladesh Bank (BB) and the People's Bank of China (PBoC), to make such an overarching arrangement work. Indeed, if and when CEPA between the two countries was to be signed, such an agreement could constitute one of its central components.

CONCLUDING REMARKS

The analysis presented in the preceding sections argues in favour of the need for Bangladesh to look at the fast-growing Chinese import market as a strategic export opportunity for the country. Over the past years, China has been able to make significant inroads into Bangladesh's import market. China is also major player in the borrowing scenario and in view of infrastructure investment in the country. However, on its part, Bangladesh has not been able to take advantage of the growing import market of China in spite of the preferential treatment offered by China for almost all items of the export from Bangladesh.

In this backdrop, the present study has tried to argue that there are significant export potentials for Bangladesh in the Chinese market. The study found that there is a large number of items which are imported by China from other countries, but not from Bangladesh, while Bangladesh exports the same items to other countries, but not to China. The analysis based on ITC export potential map also indicates that there are many items in which Bangladesh has the potential to increase her exports to the Chinese market. Development of production networks and value chains in such areas as assembling industries, medium to high-end apparels, labour-intensive products, leather and footwear, pharmaceutical products and others are likely to have high export possibilities in the Chinese market.

Building supply-side capacities, diversification of production and raising competitive strength are the key drivers of export growth. For these to be realised, attracting FDI from China to the CEIZ as also the Special Economic Zones in Bangladesh will be crucial. Reallocation of sunset industries from China could also play an important role here.

The analysis bears out that a mere FTA with China will not bring tangible benefits to Bangladesh, rather it will have significant negative implications from fiscal perspective (formidable revenue erosion). The payoff matrix calculated by the authors (based on Game theory exercise) reveals the expected payoffs for both the countries, under different scenarios. Based on the exercise, an FTA with China is not advisable. However, our analysis shows that there is significant export potential in a number of products if appropriate strategies are pursued within the ambit of a comprehensive economic partnership agreement. This should include, along with an FTA, an investment deal, as also other avenues of deepening bilateral economic co-operation.

The study argues that in preparing for strategic partnership with China, Bangladesh should clearly identify its offensive and defensive interests, should carefully weigh revenue loss implications, desired rules of origin, attract Chinese investment to Bangladesh (particularly in the dedicated CEIZ and SEZs), stimulate and incentivise technology and know-how transfer to Bangladesh, and explore the potential opportunities of currency co-operation.

[12] Share of Yuan in Bangladesh forex reserve is envisaged to be less than 2%.

[13] De-dollarisation and internationalisation of Yuan appear to be moving in tandem. Share of Yuan as a global currency in overall trade related transactions is rising. It's share in global trade finance rose to 5.8% in September 2023. In recent times India had opted to trade with Russia in Yuan, albeit for a limited period.

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