

Compensated depreciation: An innovative strategy for inflation control

Wednesday, Nov 11, 2026

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Bangladesh has taken the orthodox approach. Fight inflation with high interest rates. Yet prices remain stubborn, investment is subdued, and exporters face rising costs. What if part of the solution lies not in the central bank's policy-rate announcement, but in the tariff structure?

The missing link is the exchange rate. Between June 2022 and June 2026, the taka weakened

from about Tk 87.3 to Tk 123 per US dollar—a depreciation of roughly 40 per cent. Over the same period, inflation averaged around 9 per cent. Food, fuel, machinery and industrial inputs became costlier, squeezing households and businesses alike.

But depreciation delivered a second blow that rarely makes the headlines. Bangladesh taxes a wide range of imports heavily in order to collect revenue or provide protection to import substitute industries. When the dollar price of an imported item stays unchanged but its taka price rises (due to depreciation), customs duties calculated on that taka value rise too—even if Parliament has not changed a single statutory tariff rate. The 40 per cent depreciation shock is the equivalent of a 40 per cent tariff shock, one-to-one. But this fact is hardly understood or talked about in the local trade policy discourse.

A fundamental proposition of trade economics is as follows: an X per cent depreciation is the equivalent of an X per cent export subsidy and an X per cent import tax. The latter serves as a trigger for inflation. International Monetary Fund (IMF) research (Article IV consultations report 2023) showed that 50 per cent of the uptick in 2023 inflation rate was triggered by the exchange rate shock.

The transmission from exchange rate depreciation to prices happens via the tariff effect. This neglected exchange rate and tariff connection could also be an opportunity.

A remedy from the trade economist's toolkit: Half a century ago, development economist Béla Balassa proposed "compensated devaluation": devalue the currency to strengthen export incentives while cutting tariffs to blunt the rise in domestic import prices.

Today, in an era of flexible exchange rates, "compensated depreciation" is the better label. What it implies is that exchange-rate changes countered by tariff adjustment could serve as an integrated package for neutralising the price effects of depreciation.

Consider a hypothetical 10 per cent depreciation—from roughly Tk 100 to Tk 110 per dollar. An exporter receiving $1 million would earn about 10 per cent more taka before allowing for changes in costs and prices. This is an across-the-board exchange-rate incentive, not a cash subsidy paid by the Treasury. It reaches garment exporters and potential exporters of footwear, pharmaceuticals, light engineering, agro-processed goods and countless other

products alike.

But importers also pay more taka per dollar. Customs collects more on dutiable goods, raising production costs and retail prices. A 10 per cent tariff yields Tk 11 revenue rather than Tk 10, equivalent to a 10 per cent uptick in tariff.

Here is where the Bela Balassa principle comes in: reduce tariffs in a calibrated manner at the same time. The aim is to keep duty-inclusive import prices broadly stable, even as the exchange rate gives exporters higher taka receipts. The tariff adjustment absorbs some of the inflationary pressure that would otherwise follow depreciation.

The arithmetic demands care. A 10 per cent depreciation does not mean a ten-percentage-point tariff cut will precisely offset it for every product. The required cut depends on the initial duty rate and other import taxes. Imagine what a 40 per cent depreciation over three years has done to domestic prices! Those high tariffs that Bangladesh is known for are also up 40 per cent since 2022 since no tariff cuts have taken place. It is no surprise that prices of imports and import substitutes are so much higher than in neighboring countries. That means only significant tariff cuts – say, 10-20 per cent — will be needed to offset the effect on domestic prices of 40 per cent depreciation. What is needed is detailed product-level calculations, to design a package that substantially cushions price effects while preserving the export incentive. The FY2028 Budget can offer that scope.

Anti-export biasn IS the real enemy: Despite heightened focus on exports, incentive policies in Bangladesh have an anti-export bias. Why is this especially relevant to Bangladesh? Because ours is not merely an economy with import dependence. It is an economy where high import protection has long rewarded selling in the domestic market more generously than competing on the world market.

100 per cent export-oriented garments largely escape this trap through bonded warehouses and duty-free inputs that literally guarantee a free-trade channel. Non-garment exporters who also produce for the domestic market face dutiable inputs while import-substituting output enjoys heavy tariff protection. Selling at home most often pays better than exporting.

That is anti-export bias in action. We lament the concentration of exports in garments while

maintaining a policy architecture that discourages other industries from entering global markets.

This is where compensated depreciation kicks in. 40 per cent depreciation over the past 40 months has raised export receipts in Taka. It has also added extra protection to import substitutes from higher tariffs. Tariff cuts on industrial inputs can reduce costs. Deeper tariff rationalisation beyond the offset can then shrink anti-export bias further. The entrepreneur's calculation changes: why settle for the protected home market when exporting can pay?

Better ports, energy, skills and trade finance remain essential. But they cannot fully overcome policy incentives tilted against exports.

The revenue argument does not settle the matter: Mention tariff cuts to the National Board of Revenue (NBR) and the familiar objection appears: Bangladesh cannot afford to lose customs revenue. Fiscal pressure is real. But the claim that lower tariff rates automatically mean lower revenue does not withstand historical scrutiny.

During the reforms of the 1990s, Bangladesh reduced average nominal tariffs from roughly 90 per cent in 1990 to about 45 per cent by 1995. Yet customs revenue grew by an average of around 11 per cent annually over the decade. That experience is no guarantee of a repeat performance, but it demolishes the notion that tariff rationalisation and revenue growth are inherently incompatible.

Depreciation enlarges the taka customs tax base. Carefully adjusted tariffs can offset that windfall, while lower barriers may increase imports. Revenue neutrality must be tested through simulation, not assumed.

There is also a wider fiscal question. What is the true cost of protecting high-margin domestic sales while exporters struggle to grow? Lost investment, a narrow export basket and slower job creation do not appear on a customs-revenue statement. They remain costs to the economy nonetheless.

An overdue budget decision: Successive budgets have allowed opportunities to slip away. The FY2025, FY2026 and FY2027 budgets could have used tariff reductions to counter the

inflationary aftermath of depreciation while moving Bangladesh toward a more competitive trade regime. Instead, the protective tax-revenue structure remains largely intact.

More substantial reform is overdue. Against the backdrop of 40 per cent exchange rate depreciation over three years, a 10–20 per cent rationalisation of tariff levels deserves serious consideration, with the exact schedule informed by impacts on prices, government revenue, effective protection and export incentives.

Finance and commerce ministries, NBR, Bangladesh Bank and independent economists should model exchange-rate and tariff combinations product by product. They must identify sensitive goods, estimate revenue effects and publish a phased schedule, implemented through the budget and monitored against actual prices and exports.

The exchange rate must not become another sacred number: There is a second danger in the present policy debate. Fear of inflation can tempt policymakers to hold the nominal taka-dollar rate artificially steady. But if Bangladesh's inflation exceeds that of its trading partners, a stable nominal rate can mean appreciation of the real effective exchange rate. Exporters then lose competitiveness even though the exchange-rate quotation looks reassuringly unchanged.

A currency can appear stable on the screen while becoming steadily less competitive in the factory.

Bangladesh Bank should avoid an overvalued real exchange rate, while resisting any notion that depreciation alone is an export strategy. Depreciation without supportive tariff and monetary policies can simply import another round of inflation. Tariff reform without exchange-rate realism may leave exporters struggling against real appreciation. Coordination, not isolated intervention, is the answer.

The urgency extends beyond today's inflation numbers. Bangladesh faces the demands of export diversification, trade negotiations with major partners and eventual LDC graduation. The additional breathing space toward a 2029 transition should be used to dismantle anti-export bias—not to postpone the reckoning.

We have treated inflation control, tariff reform and export promotion as three separate battles. They are connected through one critical price: the exchange rate. Balassa showed how to turn that connection into policy.

The choice is not between protecting consumers and supporting exporters. With well-calibrated compensated depreciation, Bangladesh can pursue both—while preserving a credible path for customs revenue. The tariff wall that once sheltered domestic industry should not be allowed to become a permanent tax on consumers and a brake on export growth.

It is time to stop treating the tariff schedule as untouchable. The next breakthrough against inflation may come not from another rise in interest rates, but from lowering the protective tariff on imports

Bangladesh can use compensated depreciation to tackle inflation, strengthen export competitiveness, and reduce anti-export bias through coordinated exchange-rate and tariff reforms.

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