Why exports are under-performing

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Bull Run may be over: The current state of our export performance should be a wake-up call. For two decades, 1991-2011, Bangladesh exports were on a tear, growing at double-digit average annual rate of 14 per cent. Ready-made garment (RMG) exports led the pack, averaging 18 per cent growth in this period. Economists monitoring the export performance were confident that finally Bangladesh had got a good handle on competing in global markets and our entrepreneurs were second to none. That period now looks like a bull run for exports. Since fiscal year 2012, that kind of export dynamism appears to have waned, replaced by a moderate performance of barely 7.0 per cent average growth. The latest figures for FY2018 are not flattering at all: total exports of $36.7 billion; growth of 5.8 per cent over FY2017, with RMG growing at 9.0 per cent, while non-RMG exports declining 9.0 per cent.

A review of data in Table 1 reveals the arithmetic of export performance and growing export concentration. For 20 years since 1991, RMG exports growth averaged 18 per cent, while non-RMG exports lagged behind with barely 10 per cent growth. The result was more export concentration in RMG. Export diversification was stalled, if not stymied. Clearly, this is not the kind of export growth that the 6th and 7th Five-Year Plans had stipulated as the basis for rapid export-oriented manufacturing development leading to gross domestic product growth (GDP) growth acceleration reaching 8.0 per cent by 2020. Given the two decades of stellar growth performance, double-digit export growth with its diversification was taken for granted in the two 5-year Plans. It did not happen that way. And it is important to find out why.

Several questions come to mind. What happened? Has the bull run ended? What can be done?

Searching for causes of export under-performance: First, and to be fair, two recent events that drew global attention did much to dampen buyer interest in our leading exports, readymade garments: the Rana Plaza collapse and Holey Artisan Café episode. Hopefully, those episodes are behind us, though no one doubts that they had a deleterious effect on our RMG exports since 2012, more than the global financial crisis of 2008. For the long term, the Rana Plaza event might have been a boon. Thanks to the combined efforts of the government, RMG entrepreneurs, and the two buyer initiatives on Fire and Building Safety (Accord) and Worker Safety (Alliance), we now have some of the most compliant RMG factories in the world, not to mention many of the top eco-friendly ones too. This clearly bodes well for the future.

Is the slow global economic recovery to blame? Not any more, particularly when one of our main competitors, Vietnam, has shown stellar export performance in the past five years, clocking average growth of 13 per cent, compared to Bangladesh's 7.0 per cent (Table 2). What is notable is that Vietnam's total exports crossed $227 billion in 2017, in an economy with GDP of $223 billion! World Bank data reveal that Vietnam with $31 billion of apparel exports (HS61-62) in 2017, topped Bangladesh exports of $28 billion in FY2017 and $30 billion in FY2018. And Vietnam's exports are diversified enough to include substantial exports of electronic goods (mobile phones), machinery and electrical products, footwear, and agricultural products. Vietnam continues to gain market share in USA while Bangladesh's

share of 6.0 per cent has remained steady.

What propelled Vietnam ahead in apparel exports when export destinations and buyers (brand name companies) are about the same? There is one striking difference between Bangladesh and Vietnam – role of foreign direct investment (FDI) in the economy. FDI has averaged 6.0 per cent of GDP in Vietnam in the last five years ($14 billion in 2017) compared to barely 1.0 per cent ($1.7 billion) in Bangladesh. Besides bringing capital, technology, and management, FDI opens foreign markets and creates jobs. Vietnam's apparel sector is largely FDI-driven accounting for 60 per cent of the industry unlike Bangladesh's apparel industry made of predominantly indigenous investors (except in Export Processing Zones or EPZs). Given Vietnam's positive lesson from FDI-driven apparel sector it is high time to explore how FDI could be augmented in Bangladesh's RMG industry, particularly outside of EPZ. Without that Vietnam's apparel exports appear poised to capture a greater share of markets in USA and Europe, at the expense of Bangladesh.

Vietnam aside, doing nothing is no longer an option. Our frequent claim as a "model of development" is at stake. So are many of our ambitious goals of development in our Perspective Plan 2021, and 6th and 7th 5-year Plans. In case we are missing the point, robust export performance, dynamic export-oriented manufacturing development, and accelerated GDP growth – the three principal targets of all our development plans – are closely interlinked and interdependent; one cannot be achieved without the other. Sadly, this strong message of interlinkage and interdependence is not getting through to where it is needed.

Stepchild of exports – non-RMG: Policy Research Institute of Bangladesh (PRI) research has clearly demonstrated why we need to look at RMG and non-RMG exports differently. It is important to recognise the clear dichotomy in our export scenario. RMG is on a different track altogether as far as production structure, global demand, and domestic policies are concerned. Non-RMG exports which also have worldwide markets suffer from a less favourable policy regime at home. To be sure, while the RMG sector has matured, many other labour-intensive exports are waiting in the wings, to take off. But that is not happening. Why?

Imagine for a moment our export basket devoid of RMG. That would leave our exports at only $6.0 billion in FY2018 with few sparks to show for. Data shows non-RMG exports growing at an anemic rate, well behind RMG, for two decades since 1991, thus showing little or no

progress in export diversification. To be fair, in FY2018 we exported some 1350 distinct products (at HS-6 digit level) to over 100 countries of the world. But none of them have risen in export volume to come even close to RMG. Export products that recently crossed the $1.0 billion threshold include Footwear and leather goods, Home Textiles, and Jute manufactures. The one policy support meted out to a selected number of non-RMG products was to give cash subsidy ranging from 5.0 per cent (jute yarn and twine) to 20 per cent (frozen vegetables). The practice of giving cash subsidy to selected exports has existed for decades (e.g. frozen shrimps), but there is no evidence yet to show that these subsidies have been effective in boosting exports.

So, what is keeping non-RMG exports from increasing their share in our export basket? The standard explanation most analysts will come up with is the economy's "supply side constraints" like trade infrastructure (e.g. port inefficiency and congestion, poor condition of road and rail transport infrastructure, power and gas shortages) and the generally high cost of doing business which undermine cost competitiveness of our exports. That is enough to take away the edge we have from our labour cost advantage in the global market for labour-intensive products. While this is a valid argument, summed up as "trade costs", it must be pointed out that it adversely affects our export performance in general – both RMG and non-RMG exports. It is fair to say that in the competition for infrastructure and other trade services, RMG exports receive preferential treatment being the established export leaders.

One economy, two trade regimes: RMG and non-RMG — the two export groups — are subject to divergent policy regimes. RMG sector is the beneficiary of an exclusive trade regime (duty-free import of inputs under bonded system, back-to-back LC system where export receipts cover the cost of imported inputs, and tax-free exports) which is almost equivalent to a free trade regime. The system of duty-free imported inputs is not a policy support or incentive but a policy requirement for all exports in a regime of non-zero tariffs. The objective is to provide world-priced inputs in order to level the playing field in the global marketplace. If history is any guide this has been singularly the most effective policy regime that made Bangladeshi garments most price competitive to capture the largest apparel markets in the world – USA and Europe.

For all the progress that has been made in ensuring duty-free imported inputs to non-RMG exporters, the policy regime is still discretionary and a poor match to the RMG free-trade

enclave. For instance, footwear exporters are selectively granted bonded facilities but with a host of conditions that deviate from conditions that prevail for RMG. The labour cost competitive advantage of non-RMG exports thus remains significantly curtailed.

That is not all that detracts non-RMG producers from export propensity. Domestic policies of industrial protection via high tariffs present a built-in anti-export bias that affects non-RMG exporters as they are faced with a choice to produce for exports or sell in the domestic market. To the extent that high protection raises profitability of domestic sales over exports they also result in perverse incentives and deter export diversification. Export performance, particularly of non-RMG products, continue to flounder as export markets appear less profitable than domestic markets.

Export demand is not a constraint: In principle, being a small player in the global export market there should be no dearth of demand for labour-intensive manufactures that Bangladesh can produce competitively. Our total exports are an infinitesimal share (0.2 per cent) of global exports. Of course, we can export many times more by becoming even more cost competitive with improvements in our trade infrastructure.

Two more inter-linked factors can be identified as reasons for under-performance of exports, particularly non-RMG: value chain integration and lack of FDI. Fragmentation of production and vertical integration across countries through trade in intermediate goods is fast becoming the dominant trading pattern. With growing cross-border inter-industry linkages, called value chain integration, trade in intermediate goods (parts and components of products) has been the fastest growing segment of international trade in the past 25 years or so. FDI from Transnational Corporations (TNCs) has been the driving force behind such value chain integration. RMG industry evolved through such inter-industry integration: initially, much of the yarn, fabrics, and accessories of apparels had to be sourced from other countries, with the final fabrication (cutting and making) taking place domestically. But Bangladesh has been slow to pick up this predominantly export-oriented production feature in the non-RMG sectors.

Non-RMG export sector in Bangladesh therefore lacks both FDI and cross-border value chain integration. That is another difference from the RMG industry. More than capital, FDI brings technology, management, and market access. FDI inflows into some non-RMG sectors, like

footwear and leather goods, could be the conduit to break into foreign markets in a big way. Retail markets around the world are dominated by brand name products. To access these markets for any new products from Bangladesh, it is not enough to be cost competitive; you have to have the right partners (or link to buying houses of brand names) to open markets (e.g. for footwear, toys, and electronics). We have all the export success lessons right at our doorstep. Not drawing lessons from our own successes continues to sap our export performance.

So what are the takeaways from the latest export performance. First, the policy regime for RMG sector is by and large on the right track and must be sustained. Second, RMG export dynamism can be restored, but with more FDI inroads into this leading sector. Third, RMG policy regime (particularly, duty-free bonded imports of intermediate inputs) must be given to ALL non-RMG exporters, small, medium, and large. Fourth, to boost non-RMG exports and diversify our export basket, rationalising the protection regime is now a national imperative, to make non-RMG exports relatively more profitable than domestic sales. Fifth, trade facilitation must be geared up through improvement in soft and hard trade infrastructure (e.g. ports, customs, regulatory compliance, etc.) to ensure cost competitiveness of our exports in a global market where demand is not a constraint. Finally, the good name brought home by RMG success story is the capital to use for an all-out effort to woo TNCs for FDI and joint ventures in non-RMG sectors.

If these actions are done fast and done right, many more export success stories are bound to emerge. What Vietnam has done, Bangladesh can do better.