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Bangladesh's Export Growth: Lesson for Pakistan

Manzil Pakistan is a national non-profit think tank dedicated to developing and advocating public policy that contributes to the development of Pakistan. Our aim is to shape Pakistan to a country where policies on decisions of national interest are driven by non-partisan strategic thinking and implemented through consensus in the best interest of the people of Pakistan.

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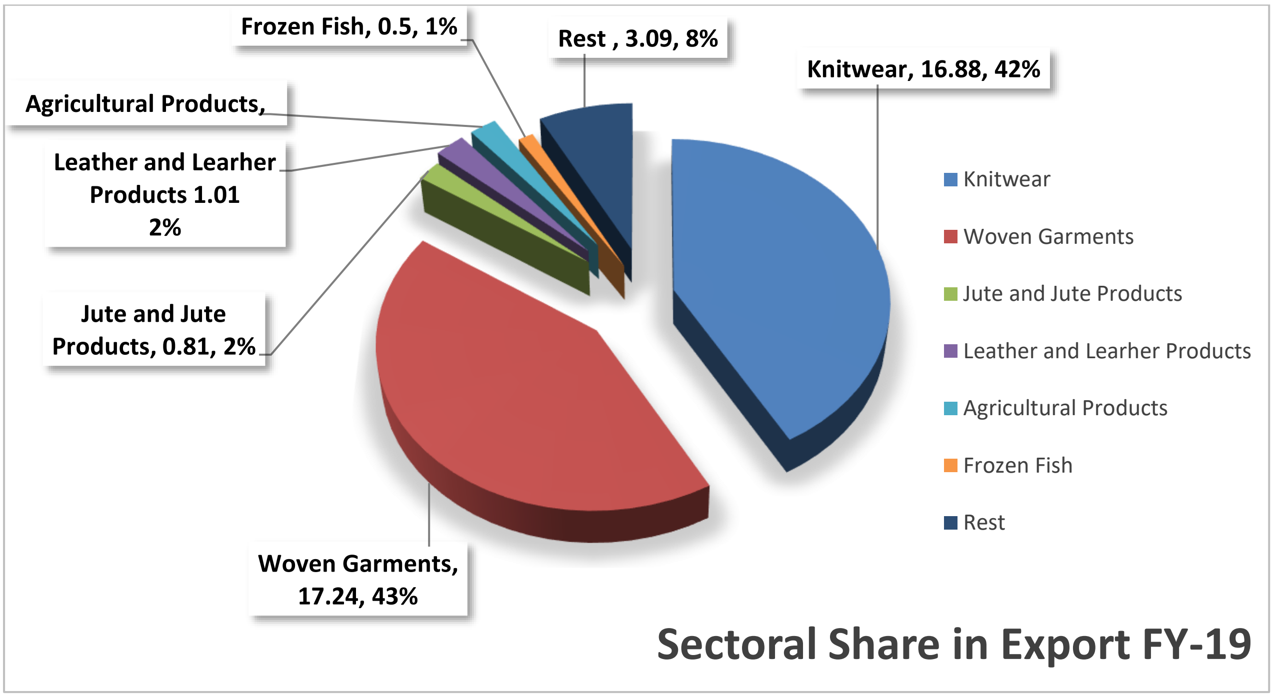
Introduction:

Managing an economy is immensely intertwined affair. There are no short fixes and policy maker has to follow economic principle and fundamentals to attain sustainable growth. Every country has their own set of problem and a policy maker has to deal with them considering the basic economic principles.

Bangladesh has emerged as an export giant for the last decade displaying massive export growth. It has become one of the Asia's most significant and remarkable success stories. Came into existence in 1971, it was afflicted with famine and poverty. It was 2006 when Bangladesh blinked into the world radar and reported a faster growth than Pakistan. That year turned out to be an inflection point and ever since Bangladesh has reported higher GDP growth by around 2.5 percent than Pakistan.

Bangladesh was getting into the export stride in 2006 and had export earnings of $12 bn. Having massive export growth over successive year the export earnings is now being raised to $40 bn. Readymade garment sector (Knit wear and Woven garments) contributed more than 85 percent in this export earnings. In early 2000 RMG sector's share in global market was 2.5 percent which has now rose over 6.5 percent.



The current document is a preliminary review of Banglasdesh exports and growth patterns. The documents also look at the structural initiatives that have been taken to achieve boost in exports. The economy of Pakistan is currently faced with low and fragile GDP growth rates, facing high current account deficits due low export growth and high growth in imports. This document is an internal document of Manzil Pakistan, and solely for the purpose of policy making for any structural reforms in Pakistan. The document is largely a compilation of reports from other institutions including reports of State Bank of Pakistan.

Background:

In Pakistan, policy makers had to deal with the troubling dilemma of plugging external financing gap after every five years or so. Although the cause of this financial gap can be different; it could be due to unwarranted spending, adverse global economic situation or domestic political transition but these causes' only triggers this current account deficit crisis. These causes are not the defining factor; until we structurally straighten our economy,hencethe Current Account Deficit (CAD) crisis could not address permanently.

July 2018 was no different; the current account deficit was $18.2 billion almost 6 percent of GDP raised form $2.7 billion which was 1 percent of GDP in 2015. Since 2015, the CAD crisis has be ever increasing and the trigging factor behind such rise was somewhat increase in importsdemandas well as increase in imports by means of increasing prices of Oil in the international markets. The issue remains that why Pakistan seems to end up in this crisis more than other countries that have similar economic structure and financial cushion.

There are two major determinants of current account, Imports and Exports. Generally, the ideal situation is when Imports and exports raise symmetrically, there is no such crisis. In fact the the foreign currency gap either reduces or remain the same due to foreign remittances.However, the dilemma of Pakistan that the exports remain stagnant, hovering aroundor between $20 billion to $24 billion since last so many years.On the other hand, the imports have been rising consistently over the last few years, leading in to increase in deficit in the current accounts of Pakistan.

Analyzing export-import trend identifies that asymmetrical growth of import and export leads up to this crisis.Inorder to plug this balance of payment gap, Pakistan seeks assistance from IMF and other friendly countries. UNCTAD's annual flagship 'Trade and Development Report 2019' commented that

"Pakistan is in the midst of crisis"

as rupee is depreciated significantly, growth rate is been halved and balance of payment is in poor state.

Expanding the export is the only viable long term sustainable solution to this crisis. Curbing import can results in a short term relief but it slowdowns the economy resulting into aggravating other macroeconomic issues. Expanding export is not that easy but there are countries that have improved their exports immensely. Bangladesh is one of countries that had a phenomenal growth of export and can offer a road map for Pakistan to improve its export side.

Initiatives that lead to Export lead Growth of Bangladesh:

Export incentives are tax programs, regulatory relaxations, legal or monetary programs to encourage export of certain types of goods and services. It's an assistance designed by government to help businesses within a national economy to secure foreign market. Incentives are crucial for businesses to incline producing exportable products and keep the product competitive in the global market.

Export subsidies, cash incentives and government financed international advertising are few forms of incentives. This enormous export growth of Bangladesh is a reflection of conducive export environment created by different tax and cash back incentives. Inorder to sustain this export growth Bangladesh has strategically incentivised their business sector with these four core incentives;

- Tax Incentives
- Cash based Incentives
- Incentives for Exploring New Markets
- Incentives for Potential Export Industry for Diversification

These incentives helped businesses competitive to the global market and encouraged businessmen to produce exportable commodities. Being a labour intensive country where capital constrains production these tax incentives also attracted investors to invest in particular sectors creating marginal capital to accommodate this enormous growth.

Tax Incentives:

Bangladesh's government has incentivised the business through different tax benefits and exemptions. These tax benefits create a business conducive environment and encourage economic activity in its economy.

Special Economic Zones and Developing Unit

Investment in SEZs

Year	Exemption % of income
1^{st}, 2^{nd} and 3^{rd}	100%
4^{th} year	80%
5^{th} year	70%
6^{th} year	60%
7^{th} year	50%
8^{th} year	40%
9^{th} year	30%
10^{th} year	20%

Developing Unit in SEZs

Year	Exemption % of income
1^{st}, to 10^{th} year	100%
11^{th} year	70%
12^{th} year	30%

Hi-Tech Park Zone

Investment in Hi-Tech Park

Year	Exemption % of income
1^{st}, 2^{nd} and 3^{rd}	100%
4^{th} year	80%
5^{th} year	70%
6^{th} year	60%
7^{th} year	50%
8^{th} year	40%
9^{th} year	30%
10^{th} year	20%

Developing Unit in Hi-Tech Park

Year	Exemption % of income
1^{st}, to 10^{th} year	100%
11^{th} year	70%
12^{th} year	30%

International Taxation

DoubleTaxRelief

Double Taxation Avoidance Agreement

1	UK	18	Belgium
2	Singapore	19	Thailand
3	Sweden	20	Poland
4	Republic of Korea	21	Philippines
5	Canada	22	Vietnam
6	Pakistan	23	Turkey
7	Romania	24	Norway
8	Sri Lanka	25	USA
9	France	26	Indonesia
10	Malaysia	27	Switzerland
11	Japan	28	Oman (air traffic only)
12	India	29	Mauritius
13	Germany	30	United Arab Emirates
14	The Netherlands	31	Myanmar
15	Italy	32	Kingdom of Saudi Arabia
16	Denmark	33	Kingdom of Bahrain
17	China		

Partial tax exemption for newly established undertaking

Area	Year	Exemption % of income
Dhaka, Mymensingh and Chittagong Divisions excluding Dhaka, Narayanganj, Gazipur, Chittagong, Rangamati, Bandarban and Khagrachari Districts	1^{st} and 2^{nd} year	100%
	3^{rd} year	60%
	4^{th} year	40%
	5^{th} year	20%
Rajshahi, Khulna, Sylhet, Barisal and Rangpur divisions (excluding City Corporation area) and Rangamati, Bandarban and Khagrachari Districts	1^{st} and 2^{nd} year	100%
	3^{rd} year	70%
	4^{th} year	55%
	5^{th} year	40%
	6th year	25%
	7^{th} to 10^{th} year	20%

Partial tax exemption for newly established physical Infrastructure facility

Year	Exemption % of income
1^{st} and 2^{nd}	100%
3^{rd} year	80%
4^{th} year	70%
5^{th} year	60%
6^{th} year	50%
7^{th} year	40%
8^{th} year	30%
9^{th} year	20%
10^{th} year	10%

Income from the business of software development or Nationwide Telecommunication Transmission Network (NTTN) and information technology enabled services (ITES)

Export Processing Zones

Area	Year	Exemption % of income
Dhaka, Mymensingh and Chittagong divisions excluding Rangamati, Bandarbon and Khagrachari districts	1^{st} and 2^{nd} year	100%
	3^{rd} and 4^{th} year	50%
	5^{th} year	25%
Rajshahi, Khulna, Sylhet and Barisal divisions and Rangamati, Bandarbon and Khagrachari districts	1^{st}, 2^{nd} and 3^{rd} year	100%
	4^{th}, 5^{th} and 6^{th} year	50%
	7^{th} year	25%

Income from exports

50% of income derived by any taxpayer from export shall be exempt from tax

Tax exemption for Public Private Partnership (PPP) Project

Income Tax exemption of the business income of PPP Project:

Income Tax exemption of capital gains arising from the transfer of share capital of PPP Project Company, Royalty, Technical Know-how and Technical assistance fee paid by such company

Income Tax exemption for foreign technicians employed in PPP ProjectCompany:

* For further details, please see KPMG tax profile for Bangladesh : https://home.kpmg/content/dam/kpmg/xx/pdf/2018/12/bangladesh-2018.pdf

Cash based Incentives:

Cash incentives are another form of supporting the industry and encouraging its export oriented outlook. Bangladesh released more than 106 billion taka as a cash incentive for the FY-16 to FY -18. Ready Made Garments (RMG) sector having largest share in exports enjoys 65.8 billion taka in terms of cash incentive and enjoys the advantage of the export oriented policies by the government. Exporters of Leather products receive 17.14 billion taka and agro processing sector receives 11.94 billion taka. These cash based incentives makes the producer more inclined towards setting up export units and creates competitiveness with the global market.

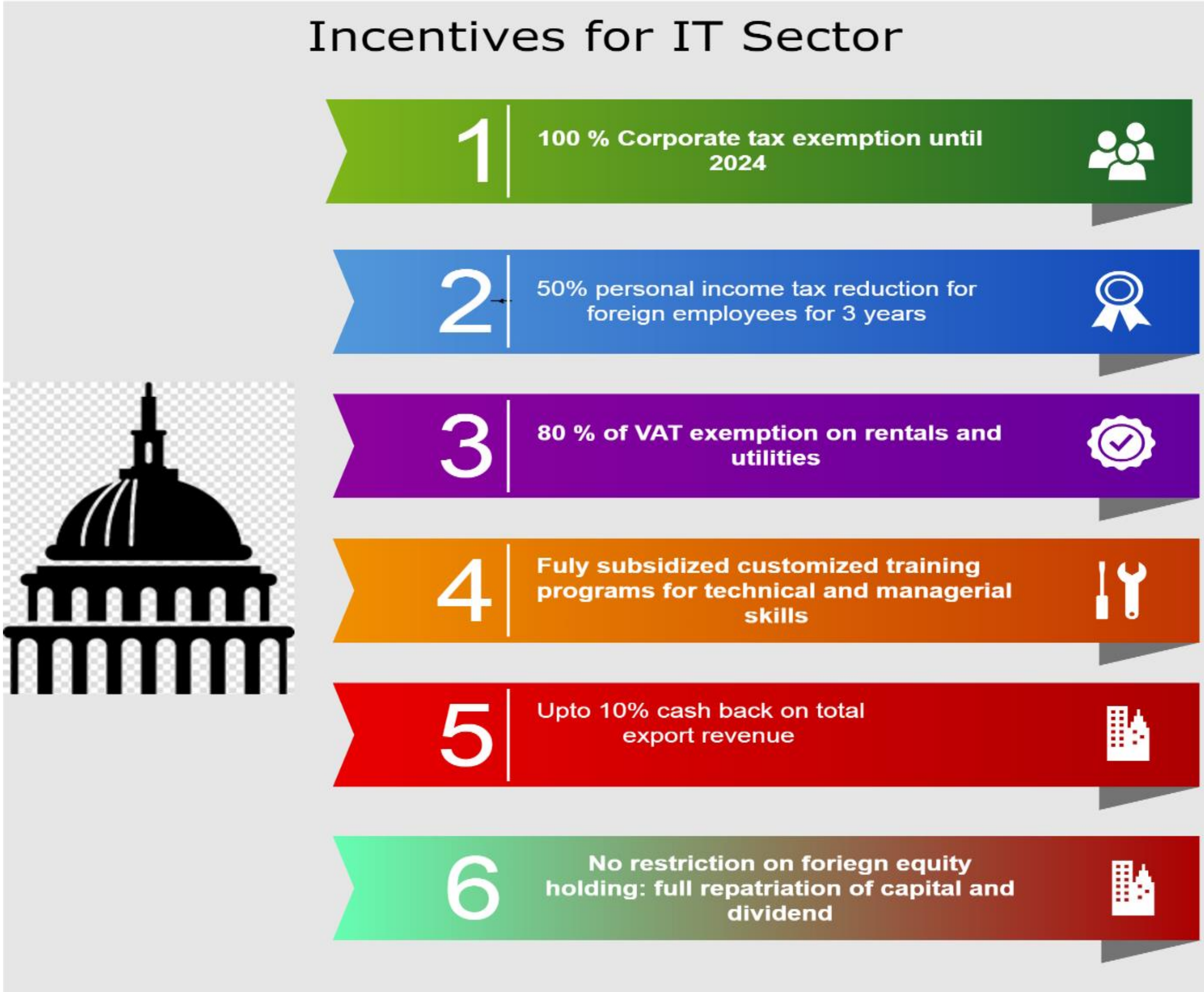
Incentives for Exploring New Markets:

For encouraging exploration of new export destinations, the Government of Bangladesh has taken increased cash incentives for apparel exporters from 3 percent to 4 percent to export in non-traditional export destination. To reduce dependency on traditional markets policy makers are incentivising the exporters exploring non-traditional markets. Reducing the export dependency on traditional markets would make Bangladesh export growth sustainable.

This policy of incentivising non-traditional markets reflected results as in FY-17 market share in apparel export was 15.09 percent. This share gradually progresses to 15.26 percent in FY-18 and in FY-19 it rose to 16.66 percent. This steady progression reflects that the export in non-traditional destinations is matching the pace with the booming export growth of Bangladesh.

Incentives for Potential Export Industry for Diversification:

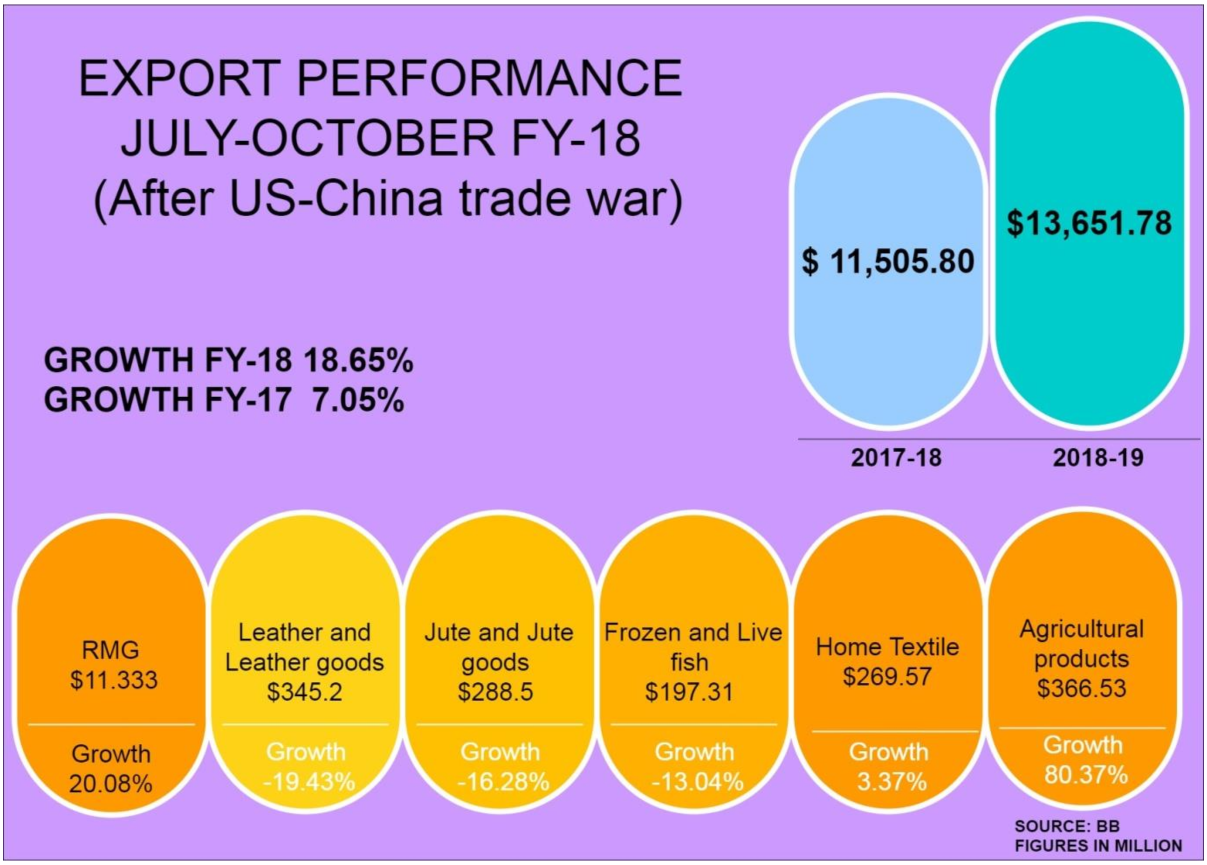
Bangladesh's economy depends upon RMG sector and it constitutes 85 percent of its exports. For sustainable export portfolio, dependency on any particular sector is adverse and policy makers have introduced policies to help develop other sectors. Foreseeing the potential of Information Technology (IT) sector Bangladesh's government has introduced enormous incentives to invest in IT sector. These incentives would help diversifying the export portfolio and help shifting the export dependence from RMG sector to other sector.



Emerging Global Scenario and Seizing the Opportunities:

Geo political relations and conflicts affect global trade dynamics. Trade conflicts between countries opens up opportunities for other global players to seize the opportunity and grasp maximum market. Inorder to seize the opportunity the country need to create a business environment with the capacity of capital and labour expansion. Good business environment, depth in production capacity (Capital and Labour) and export oriented policies provides a platform to seize the market share created due to geo political conflict.

For example, China-United States indulged into a trade war in June 2018.This ongoing conflict between two world's biggest economies has created a space for other economies to fill in the vacuum and entrench their export presence. Bangladesh was in a very poised position to take an advantage to the situation and July-October FY 2018-19 (First four months after the trade war) reflected this impact as it registered 18.65 percent export growth. Similar period of FY 2017-18 reported 7.03 percent export growth reflects huge hike due to this trade war between China and US. This trade war has diverted trade orders from China resulting Bangladesh to increase exports.



Way Forward:

Improving exports and penetrating new markets is an uphill task but with structural policy changes Pakistan can increase and diversify its export portfolio. Increasing export is a long term process and requires consistent policy initiatives to harness export oriented business environment. Learning from Bangladesh’s experience Pakistan needs to address four fundamental issues to bring Pakistan’s export industry on track.

Fundamental # 1: Incentivise and Promoting Competitive Business Environment:

Incentivising industry is an igniting factor in creating market sentiment and displaying commitment towards improving exports. Market sentiment and perception plays a vital role inclining investors towards indulging business activities and creating opportunities. Bangladesh has given four types of incentives to their business community.

- Tax Incentives
- Cash based Incentives
- Incentives for Exploring New Markets
- Incentives for Potential Export Industry for Diversification

These incentives has harnessed their export oriented businesses and helped them achieving this enormous export growth. Pakistan must draw out its own incentive plans for the businesses to be competitive and flourish.

Fundamental # 2: Identify New Export Markets:

Identifying new markets is an essential component for having improved sustainable export growth. Export dependency on any particular country would create unreliable export base. Recipient country’s purchasing power, geo political relation and other strategic interest can impact the exports. It’s important that export reliance on any particular country is minimal. Bangladesh has diversified its export destination to EU countries, UK and US and its export is now well poised among them. Slipping out any of these destinations can affect its export growth but not enough to cripple it.

Special Cash back incentives are offered to businessmen exporting to non-traditional destinations and Bangladesh’s export to non-traditional market posts 36 percent growth in 2019. This reflects that expansion of export base in terms of destinations policy is effective.

Pakistan needs policies that promote export diversification and encourage exporter to lookout for non-traditional export markets.

Fundamental # 3: Identify New Products:

Reliance on any single sector can be treacherous to the export sector. A technological change, behavioural or preferential changes can slowdown the export and its impact would be on overall economy. Bangladesh relies heavily on Readymade Garment sector and it constitutes it's around 85 percent of its overall export. Realizing the fragility of the situation Bangladesh has announced special incentives for other sectors to diversify country's export basket. Recognizing the ICT exports potential it is immensely supported by government granting tax holidays and cash back incentives. Pakistan needs to identify new products and incentivize them to be able to strengthen the export base of Pakistan in the long run.

Fundamental # 4: Invest in Human Capital and Develop Skilled Labour:

Being a Labour abundant country Pakistan seeks out for labour intensive industries. For producing quality products that are competitive enough to penetrate in global market it need to produce skilled labour. Investing in Human capital would support the labour and develop a competitive product. Skilled labour is the next big issue in Bangladesh and Technical and Vocational Training are provided by over 13,000 training centres in the public and private sectors and 1.3 million people received training on 87 trades in the country in 2017. Pakistan has to develop a labour pool that has the skilled needed for emerging market dynamics and possesses export competitiveness.