

Liberalization and Economic Growth: A Review of the Bangladesh Economy

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Abstract

This paper focuses on the benefits of openness by trade and financial liberalization on economic growth in Bangladesh. We have analyzed historical developments of major macroeconomic variables and presented charts and statistical tables. We observe that Bangladesh has had impressive growth in exports, remittances and foreign exchange reserve along with strong macroeconomic fundamental in recent years. This paper finds that trade and financial liberalization promote economic growth in Bangladesh; the degree of country's openness in terms of trade share increased to 47 per cent in FY14 from 18 per cent in 1970s. Country's exports enlarged to USD 30 billion (21% of GDP) in FY14 from USD 0.46 billion (around 3% of GDP) in 1970s. FDI inflows also has accelerated along with the increasing trend of remittances inflows. The country experienced surplus current account balance since FY02 except for a deficit recorded in FY11 and FY12. Nevertheless, foreign reserve position rose to the comfortable level at USD 21.56 billion at end June 2014 that is equivalent of 6 months of import payments from USD 1.6 billion at the end of FY00 (equivalent of 2 months of imports). These developments reveal that trade and financial liberalization encourage economic activities that accelerate country's GDP growth.

Key words: Liberalization, trade, openness, foreign exchange.

JEL Code: F14, F43, O40

1. Introduction

The literature of both classical and neoclassical growth model suggest that economic openness plays a significant role in the process of countries' economic growth. Broadly, economic openness potentially enhances the growth prospects of an economy by influencing factors such as production factors accumulation, increasing productivity and innovation. For instance, an open economy which has a comparative disadvantage for the availability of factors gets such factors of production more easily at a low prices from abroad compared to a closed one. Economic openness also leads better allocation of resources; economy becomes specialized in the sector for which it has better factor

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endowments and increase exports. In the process of economic openness technology transfer also makes benefit of the economies of trading countries by increasing in factor productivity and finally enhancing growth (Romer, 1991 and Chuang, 2000). Through the openness single country would not only get the benefit, of course trade partner country gain by proper use their resources by the movement of resources from surplus/abundant country to deficit country.

Notwithstanding that the theoretical considerations and the empirical evidence whether economic openness promotes growth is quite ambiguous. Krueger (1978), Frankel and Romer (1999), and Sachs and Warner, (1995) investigate a strong evidence of an effect of openness on economic growth. On the other hand, a few studies- Srinivasan (2001), Morgan and Wright (1998) conclude that trade liberalization may have negative impact on economic growth. The literature of Awokuse (2007), Bhagwati (1978), Edwards (1998), and World Bank (1991, 1999-2000) support that through the process liberalization of trade and financial sector both developed and developing countries take the advantages by increasing scale of economy and benefit of competitive prices.

Following the comparative advantage theory in trade, Bangladesh embarked on a path of reforms to open up its economy in early 1980s through the process of policy shifting to export promotion from import substitution by introducing the New Industrial Policy (NIP) in 1983 with the aim of improving competitiveness, enhancing economic efficiency, dismantling state enterprises' interventions, increasing participation of the private sector to foster economic growth. The process was accelerated during 1990s by liberalizing its international trade by gradually minimizing the number of items hitherto restricted to trade, by reduction of tariff level and tariff dispersion, by simplification and rationalization of the tariff structure, by deregulation of the import process as well as by providing various export incentives and joining WTO. Since then the measures were undertaken more vigorously, largely focusing foreign exchange regime liberalization, full convertibility of Taka for current account transactions and partially by opening up capital account along with financial sector liberalization to spur both domestic and foreign investment and output growth. That, in turn increased openness and oscillated GDP growth around 6 percent mark in FY04 from the moderate rate of 4.8 percent growth rate of 1990s (Figure 1).

However, wide debate of the impact of trade liberalizations on the economy of Bangladesh are mostly found in various reports of reforms programs such as 'Sectoral adjustment policy reform evaluation (Rahman 1992, Sobhan 1995, Rashid 2000). Ahmed and Sattar (2004) recognizes that trade liberalization and economic reforms contribute to the growth of output, per capita income growth, and poverty reduction. Hossain and Alauddin (2005) examine that increase trade liberalization in 1990s reduce the anti-export bias and during the post liberalization export and real GDP increased steadily. Mohiuddin and Hasan (2005) find that trade liberalization increases the trade-GDP ratio significantly and also inflate export growth. The impact of trade liberalization on the export is highly significant and positive (Nur et al 2007).

Nevertheless, Dowson (2006) has identified that trade liberalization increased the export growth but did not show any effect on the long-run export-income relationship. Raihan (2010) found that in the long run there are possibilities of reduced welfare and increased poverty. However, in the long run, resources are reallocated towards the more efficient and expanding sectors and can generate positive outcomes in terms of welfare gains and poverty reduction. Mujeri and Khandakar (2001) found that trade liberalization is pro-poor. In contrast, Mujeri and Khandakar (2002) argued that though the global process in Bangladesh was pro-poor but the gain is relatively small. Hoque (2008) found that due to trade liberalization all households' experiences increase consumption.

In this study we analyze comprehensively the progress and impact of economic openness in terms of trade liberalization, financial liberalization and capital account liberalization on country's economic growth. Here, we simply consider the trends of related and associated relationship of major macroeconomic variables- exports; imports, remittance inflows, foreign direct invest (FDI), and real sector output and GDP using charts and tables for the period FY72-FY14. Data has been collected from Bangladesh Bureau of Statistics (BBS), different ministries of Bangladesh Government, Bangladesh Bank (BB), World Bank (WB) and International Monetary Fund (IMF). We observe that openness promotes country's economic growth by increasing *scale of the economic* that accelerates manufacturing output and boosts up exports through forward linking channels.

The paper is structured as – an introduction related to the subject matter that includes a brief review of the literature in Section 1. The next- Section 2 presents a comprehensive overview of the development of different liberalization measures that undertook in different times in Bangladesh. Degree of economic openness and integration with global economy is discussed in Section 3. Section 4 describes development of outcomes of economic openness and while Section 5 briefs on openness and GDP growth. Finally, Section 6 concludes and also discusses policy implications and limitations of analysis of this paper.

2. A brief history of liberalization process in Bangladesh

In Bangladesh, the liberalization processes started in late 1970s through the denationalization of banks and industries, and the process enhanced in mid-1980s aiming to increase participation of the private sector, promoting export-led growth, improving competitiveness and enhancing economic efficiency. The policies pursued by Bangladesh government have passed mainly in three phases- the first phase (1982-86) was undertaken under the purview of the policy based lending of the World Bank (WB) (WB, 1987); the second phase (1987-91) under the three year IMF Structural Adjustment facility (SAF) in 1986; and the third phase (1991-1993) was under the IMF Enhanced Structural Adjustment Facility (ESAF). The process covers trade and financial liberalization (both internal and external) and also that of capital account liberalization. Trade liberalization is associated mainly with tariff and non-tariff parameters such as tariff rates, tariff and non-tariff

barriers; financial sector liberalization contains liberalization of interest rates, abolishing priority sector lending, improving monetary policy and so on, and while capital account liberalization includes exchange rate liberalization. The initiatives improved macroeconomic condition of Bangladesh. The detail is summarized in the following sections.

2.1 Trade liberalization

Along with the denationalization process, the declaration of the Industrial Investment Schedule in 1976, withdrawal of private investment ceiling in 1978 and introducing New Industrial Policy in 1982 the trade liberalization started in Bangladesh in mid-1970s. The process included the gradual minimizing the number of restricted items for trade, reduction of tariff level and tariff dispersion, simplification and rationalization of the tariff structure, deregulation of import process, export promotion and joining WTO, and regional organization. The export promotion policies cover - Export Performance Licensing, Export Performance Benefit Scheme, Special Bonded Warehouse Scheme, Back to Back LC System, Export Credit Guarantee Scheme, Export Development Fund, allowing retention of exchange earnings, tax-holidays for industries in Export Processing Zones (EPZs) and the like.

Under the trade liberalization process, the import policies were devised to rationalize and to simplify. In order to ensure availability of different kinds of raw materials, machinery and equipment for domestic industries tariff and non-tariff barriers, tariff rates, and quantitative restrictions (QRs) on imports were reduced gradually to promote domestic manufacturing outputs. The maximum tariff rate which was as high as 350 per cent in FY91 reduced to 37.5 per cent in FY00. The rate came down even further to 25 per cent in FY05 that is continuing. Following the policies there had a substantial reduction in the number of banned and restricted items; the total QR that was 315 in FY90 reduced to 63 in FY06 and 18 in FY13. To discourage the imports of finished and luxuries goods, tariff rates on such goods yet very high while the rates on intermediate goods, industrial raw materials, and machinery for domestic industry are relatively low and are even zero for export-oriented farms.

The un-weighted import average tariff rate was 57.22 per cent in FY92 which dropped to 14.44 per cent in FY14. The Most Favored Nation (MFN) tariff rate reduced gradually to facilitate smooth implementation of the import policy of the Government. Broadly, three types of tariff concessions on MFN rates are being provided- i) import under different bilateral/regional trade agreements, ii) imports of capital machinery and spares/parts by registered industrial consumers including export-oriented industries and iii) import of raw materials for a specific use or user (e.g. end use provisions) such as dairy and poultry, pharmaceuticals, leather and textile industries. The development of tariff structure in Bangladesh is given below in Table 1.

Table 1: Tariff Structure of Bangladesh

Indicator	FY91	FY00	FY10	FY14
Number of operative tariff slabs	18	5	5	5
Number of operative tariff (%)	n. a	0,5,15,25, 37.5	0, 3, 5, 12, 25	0, 2, 5, 10, 25
Maximum tariff rate (%)	350	37.5	25	25
Import un-weighted average rate (%)	88.6	22.4	13.7	14.4
Import weighted average rate (%)	42.1	13.8	6.5	n.a
MFN un-weighted average rate (%)	n.a	n.a	15	14.4

Source: National Board of Revenue (NBR). Note: n.a= not available

2.2 Financial sector liberalization

After the independence in 1971, the then government nationalized all financial institutions except a few foreign banks. Bangladesh Bank, the central bank of Bangladesh was established in 1972 and the financial sector was under a regime of rigid government control. However, the reform process in financial sector was initiated in 1982 through denationalization of two commercial banks out of the six and providing a number of licenses for private sector commercial banks. A wide range of reforms in financial sector was undertaken in early 1990s through the implementation of the 'Financial Sector Reform Project (FSRP) in 1990 that ended in 1996. The attempt includes- enhancing the capacity of monetary policy, liberalization of interest rates, abolishing priority sector lending, strengthening central bank supervision, improving the legal system and framework for loan recovery, regulating banks and deepening the capital market (Chowdhury and Raihan, 2000). The reform measures were continued and further extended as greater autonomy given to financial institutions settling deposit and borrowing rates, empowering board and management of financial institutions to take decisions independently, strengthening of criteria/procedure for loan classification and provision, implementation of Basel-II, improvement of capital positions, introducing credit information system for borrowers, rationalization of branch network, computerize and online banking, strengthening payments systems, reducing bank rate, adoption of indirect and market based monetary policy instruments. Now scheduled banks and financial institutions are almost full freedom to determine their deposits and lending rates on the basis of market forces. At present, banks are also enjoying full autonomy to charge different rates on lending for different borrowers depending on the involved risk and maturity factors except agriculture, export, small industry. Banks are also allowed to determine exchange rate freely. Besides, BB is providing prudential guidelines to banks and FIs time to time to ensure financial stability in the country.

It has been empowered the BB and financial institution through the amendment of Bangladesh Bank Order, 1972 (Amended in 2003) and Bank Company Act, 1991 (amended in 2013). Introduction of competitive auction based treasury bills and

Government treasury bonds, national payments systems and establishment of secondary bond market have also strengthened Bangladesh's financial sector.

2.3 Foreign exchange liberalization

The Bangladesh Bank, along with the Ministry of Finance, administers currency policy. Certain exchange transactions are delegated to the authorized commercial banks. The currency of Bangladesh is Bangladesh Taka (Tk), which was created to replace the Pakistan Rupee in January 1972. Before 1983, the Taka was linked to Pound Sterling. The exchange rates for currencies other than Sterling are based on the London market rates for the currencies concerned. Started from January 1983, however, its intervention currency was changed to the U.S. Dollar. With the collapse of the Pound and the dismantling of Sterling Area, Bangladesh maintained its link to the Pound causing the devaluation against the U.S. Dollar. In July 1972, a Secondary Exchange Market (SEM) System, comprised of the Wage Earners' Scheme (WES) and Export Performance Benefit Scheme (XPB), was formed. The SEM Rate was created for foreign currency remittance from Bangladesh nationals abroad.

However, in Bangladesh, the foreign exchange liberalization processes started in 1979 by dropping single currency peg (The British Pound Sterling, BPS) exchange management. Country introduced an exchange rate management that comprising weighted of currencies of major 11 trade partner countries according to their relative shares in the trade settlements. Following that a comprehensive trade-volume weighted currency basket was adopted in January 1983 (8 countries' currencies) against US Dollar as of its growing importance in international settlements. In turn, the area of foreign exchange management in Bangladesh moved to market-based floating exchange rate regime in May 2003. Under the regime, banks are permitted to quote foreign exchange freely both with bank and non-bank customers; abolished foreign exchange holding limits for authorized dealer (AD).

To develop a vibrant foreign exchange market it has been prepared Core Risk Guidelines in Foreign Exchange, formed Bangladesh Foreign Exchange Dealers Association (BAFEDA), established foreign currency clearing arrangement with BB, and introduced "Online Monitoring of Foreign Exchange Market". We observed that some countries faced an adverse reaction in adopting floating exchange rate system (India, Brazil, and Thailand) while Bangladesh did not face so. At the early stage of the floating exchange rate regime the market was almost stable with low volatility and minimal depreciation of the Taka against major trading partners' currencies due to adequate preparatory steps was taken by Bangladesh Bank. However, we experienced a sharp depreciation of Bangladeshi Taka (BDT) against USD during July 2010 to January 2012; otherwise the BDT against USD remained stable. The IMF in its country report on Bangladesh (IMF, December 2013) appreciated that the real effective exchange rate (REER) was around its fair value and was

broadly in line with fundamentals. Strong growth of wage-earners remittances from abroad and flow of foreign aid with strong export growth helped keeping competitive of BDT during the last couple of years.

Foreign exchange liberalization process enhanced with the support from IMF under SAF (1988-1990), ESAF (1990-1993) and PRGF/PRSP (1993) during 1990s. The most significant measure of foreign exchange liberalization process was the movement of current account convertibility in 1994. Thereafter, restrictions have been being gradually removed for current account transactions and extensive powers have been given to the ADs to deal with current account transactions. ADs do not require prior approval from BB to conduct current account transactions within the indicative limit as set by BB. Under the process, importers can enjoy short-term suppliers' credits or buyers' credit from abroad for tenure up to one year. Foreign owned/controlled industrial enterprises in Bangladesh are allowed to access interest free loans for working capital other than input procurements from parent companies/shareholders abroad for up to one year without any prior approval. Besides, exporters are allowed to access short-term foreign currency to import of inputs from Export Development Fund (EDF) on sight basis through ADs for up to 180 days.

In Bangladesh, capital account openness process has accelerated by launching 'The Foreign Private Invest Act' in 1980 to increase capital inflows in the form of equity or loans. Through the process, both foreign direct investment (FDI) and foreign portfolio investment (FPI) in Bangladesh are allowed except in a few reserve sectors; foreign investors are free to buy and sell debt/equity securities from/to stock markets in Bangladesh; non-resident Bangladeshis (NRBs) are also allowed to invest and to sell Bangladesh Government Treasury Bonds (BGTBs) at any time. Moreover, foreign investors are allowed to establish enterprises in full ownership and they are permitted to repatriate their dividend/profit and proceeds of liquidation of investment. Foreign owned/foreign controlled companies are also allowed to borrow in short-term or long-term from the local market and also from abroad. However, except some cases (to set up exchange houses abroad by domestic banks, to set up business office abroad for export promotion) outflows of resident-owned capital for investment abroad remain restricted since domestic savings are inadequate for the economy's own investment needs.

Table 2: A Snapshot of economic openness of Bangladesh economy

Policy Criteria	Status
Exchange Rate	Unified
Exchange Rate determination	Floating
Payment convertibility	
Current account	Yes
Capital account	Limited
Import restrictions	
Import licensing	No
QRs on imports	No
State monopolies	No
Tariff structure	
Top Rate, FY14	25
Average Protective Rate FY14	13.9
Tariff slabs (customs duty)	0, 2, 5, 12, 25
Para-tariffs	Supplementary Duties
Existence of high level of NTBs	No
Trade Openness (trade to GDP ratio) in FY14	47 %

Note: NTBs: Non-tariff barriers.

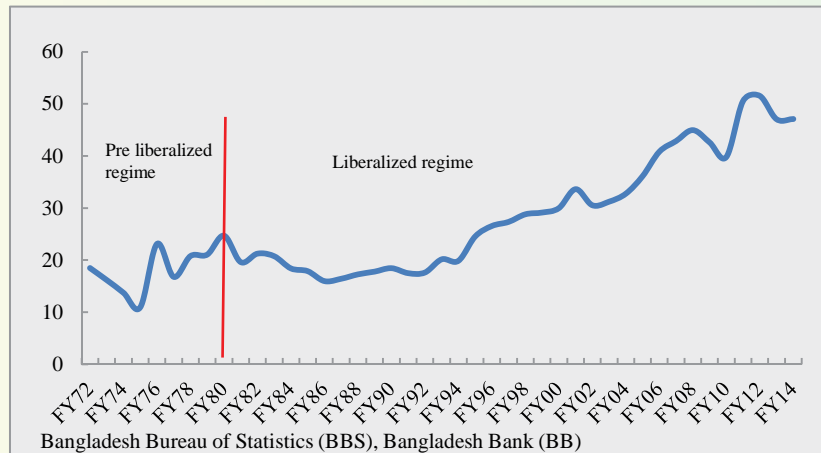
3. Bangladesh economy: Degree of openness

There is no single consensus on how to measure openness of an economy (Das, 2003). It is indeed a tough task and is a common problem across countries. Openness is neither directly observable nor is there a universally accepted measure (either theoretically or empirically). Various contending measures of openness such as trade intensity, tariff and non-tariff barriers, the indices constructed by Dollar (1992) and Sachs and Warner (1995) are used in empirical research. However, we used trade intensity (total trade as percentage of GDP) and tariff rates as openness indicator for Bangladesh economy as we see in many literatures (Harrison, 1994; Adnan. Q. M and Lau. W, 2015).

The undertaken policy measures as discussed above encourage country's participation into global economy in terms of trade of exports and imports. Consequently, the country's openness indicator measured by trade intensity (total exports plus total imports in per cent of nominal GDP) increased sharply since early 1990s and rose to its highest level 52 per cent in FY12 (Chart 1). Onward, the index decreased slightly to 47 per cent in FY14 due mainly to increase GDP as well as imports values. In terms of openness indicator, the figures reveal that the Bangladesh economy was more opened compared to other economies in the SAARC region. In India, total trade to GDP ratio increased to 43.5 per cent in FY13 from 35.4 per cent in FY10. Likewise, the Sri Lanka and Pakistan economies experienced a fall in the ratio in the last couple of years. For instance, the openness

indicator in Sri Lanka declined to 42.3 per cent in FY13 from its highest level of 66.7 per cent in FY04 and in case of Pakistan it came down from 35.5 per cent in FY06 to 27.2 per cent in FY13.

Chart 1: Trade openness in Bangladesh (FY72-FY14)



4. Development of major external and financial sector indicators in Bangladesh

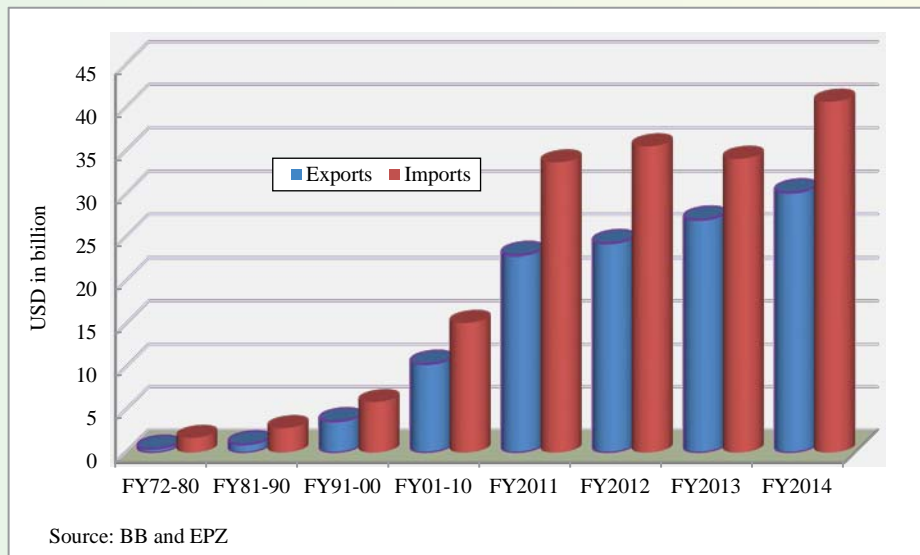
The openness through reduction of trade barriers, cutting down tariff rate, and full convertibility of current account and limited openness of capital account as discussed above has strengthened the macroeconomic fundamental of Bangladesh economy. During last decade, manufacturing output, exports earnings and remittance inflows increased significantly that reduced the trade gap. On the other hand, government expenditure mostly met by revenue earnings where the dependency of foreign debt reduced remarkably that in turn sustainable and managed a comfortable foreign exchange reserve. In landscape view we observe that these indicators contributed to accelerate the country's economic growth. The development of the most encoring indicators— exports, imports, FDI and portfolio investment, and foreign exchange reserve those have shown signs of improvement since late 1990s and the trend continued are discussed in this section based on their trends.

Export earnings: Strong export growth contributed to GDP growth. The government attempts to promote exports that in turn accelerated both the volume and value during the last two decades. During early 1980s, earnings from exports were around a half billion USD (4.0 per cent of GDP) increased almost fifteen times in 2000. The exports receipts recorded at USD 15.57 billion (17.4 per cent of GDP) in FY09 and gradually increased to USD 30.18 billion (20.1 per cent of GDP) in FY14. The export growth recorded around 10 per cent during the last couple of years (Chart 2).

Nevertheless, exports pattern has shifted to manufacturing products from agro-based

primary products due to increased integration with the world economy. In the early 1980s jute, jute products and tea were the main export items. During the 1980s the contribution of primary products in total exports was 30.0 per cent while manufacturing products contributed 70.0 per cent (of which ready-made garments was 22.0 per cent). The scenario changed over the years; the contribution of industrial products increased significantly. In FY14 manufacturing products accounted around for 95.0 per cent of total merchandise exports of which the contribution of ready-made garments (including knitwear) was 81 per cent; primary products accounted for only 5.0 per cent at this time. Steady and robust export growth has contributed to increase domestic output.

Chart 2: Export earnings and Import payments of Bangladesh (USD in Billion)

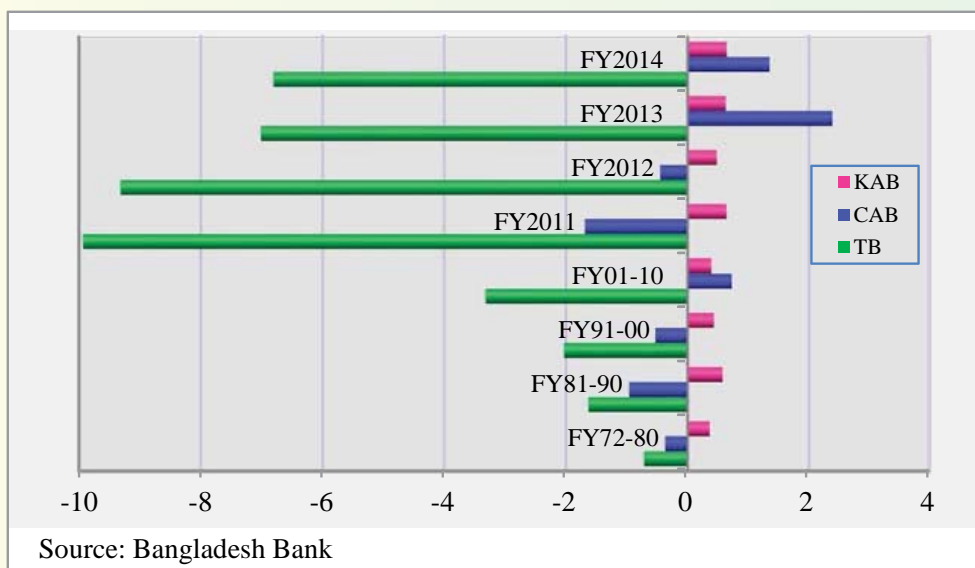


Import payments: Import of capital machinery and industrial raw material accelerate country's manufacturing output growth. The supportive measures to gear-up export-led growth, tariff rates and non-tariff barriers on imports of raw-materials and capital machinery were reduced significantly. Thus, over the period both volume and value of imports increased gradually. Import payments (c&f) increased to USD 8.37 billion in FY00 (17.8 per cent of GDP) from USD 1.71 billion (13.5 per cent of GDP) in 1970s. With the continuous increases, import payments stood at USD 40.69 billion in FY14 (27.0 per cent of GDP). However, in total import, imports of raw materials for manufacturing industries increased significantly to 23.0 per cent in FY14 from 14.0 per cent in FY95 due to boost up domestic industrial output.

Current account balance: Moderate current account balance is maintaining by the strong growth of exports and remittance earnings. Current account balance (CAB) of

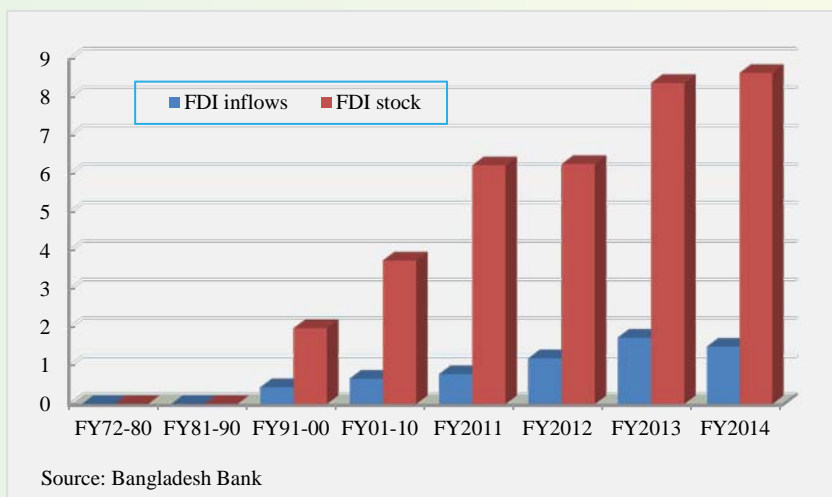
Bangladesh recorded a deficit accounted around USD 366 million and clustered around 3.0 per cent of GDP in 1970s. The CAB deficit became wider in 1980s, in average accounted USD 869 million (4.4 per cent of GDP). During 1990s the deficit narrowed and improved. Following that the CAB recorded a surplus, amounted USD 157.0 million in FY02 (0.3 per cent of GDP). The trends of surplus continued and reached to USD 3724.0 million in FY10 (3.7 per cent of GDP) except a deficit in FY05. Next two years CAB became deficit and again in FY13 it improved followed by a surplus amounted USD 2525 million that declined USD 1346 million in FY14 (Chart 3).

Chart 3: Balance of Payments of Bangladesh (in billion USD)



Foreign Direct Investment (FDI): Both foreign direct (FDI) and portfolio investments (FPI) showed increasing trend. FDI is a potent weapon for the development of any economy, especially in Emerging Market Economies (EMEs) by bridging the saving investment gap. It contributes to build up physical capital, create employment opportunities, develop productive capacity, enhance skills of local labor through transfer of technology and managerial know-how, and help to amalgamate domestic economy with the global economy. Capital flows not only enable recipient countries to achieve higher growth without sacrificing their current consumption but also provides benefits foreign investors by earning higher returns on their capital investment. Over the last decades, almost all developing Asian economies including Bangladesh have progressively adopted more open policies toward FDI flows and this trend is likely to continue in the foreseeable future.

Chart 4: Foreign direct investment in Bangladesh (in billion USD)



Bangladesh has a number of positive attributes to attract foreign investors from both developed and developing countries. Low wage rates compared to any other Asian countries, stable and single digit inflation, reasonably stable exchange rate, investment friendly custom regulations without any discrimination between foreign and domestic investors, tax holidays, and special investment zones with attractive incentive packages are available for foreign investors. In spite of, Bangladesh could not attract significant amount of FDI inflows though the increasing trends of FDI inflows has continued. In Bangladesh, FDI stock rose to USD 8.62 billion at end FY14 (6.5 per cent of GDP) from USD 3.37 billion (5.6 per cent of GDP) in FY05 (Chart 4). On the other hand, due mainly to the narrow capital market of Bangladesh portfolio investment inflows yet to significant though providing incentive measures continued.

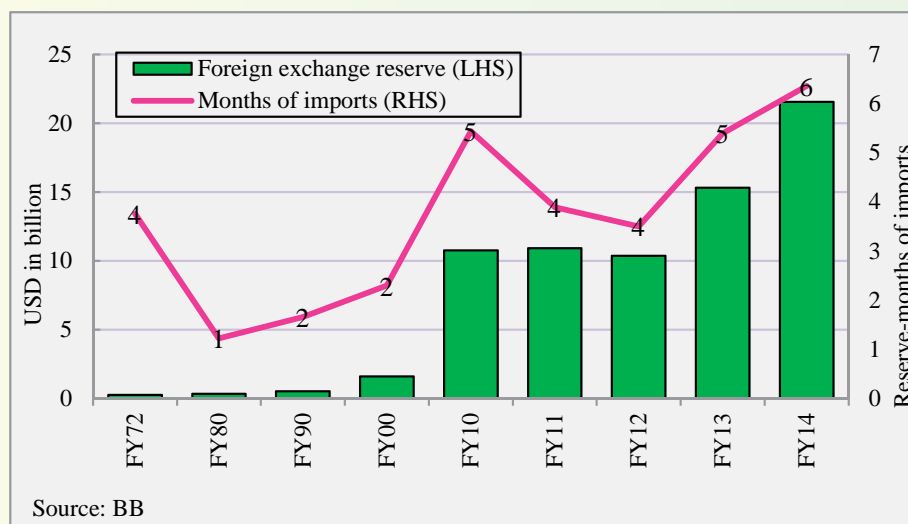
Corporate sector borrowing from abroad: To accelerate private sector, borrowing from abroad by corporate sector has been allowed very recently. Corporations established in Bangladesh are allowed to borrow on medium and long terms from abroad with prior permission of the Board of Investment. However, trends of corporate borrowing from abroad has been increasing gradually because of lower cost of fund and stable exchange rate; this amount is yet to significant (2.1 per cent of GDP at end FY13). External borrowings by the private corporate sector is well managed and under full observation of the administration to eliminate the risk of unnecessary and costly borrowing and piling up of external debt burden.

In addition, Bangladesh Bank is allowing buyers' credit for banks since 2012. Also, banks are permitted to obtain short-term credit line from abroad for discounting export bills. Both initiatives have attracted enterprises. Evidence shows that the stock of short-term borrowing from abroad stood at USD 3.14 billion at the end of February 2014. Such

substantial short-term borrowing (almost 16 per cent of foreign exchange reserve) is a signal to the authorities to take precautions since it may pose a risk to external liquidity as well as the exchange rate.

Foreign Exchange reserve: Healthy foreign exchange reserve buffer foreign exchange market. Due to undertaken different pragmatic measure and a strong export growth and remittance inflows contributed to build up a comfortable foreign exchange reserve in Bangladesh. The foreign exchange reserve stood at USD 21.56 billion at end June 2014 which was equivalent more than six months import payments (Chart 5). However, Bangladesh started its journey with a foreign exchange reserve amounted USD 270 million only in 1971. The reserve was below a half billion till mid 1980s by which covered only two months of imports. Large import payments on food items and fuel, and small exports base was the main reason of small reserve. Moreover the oil price shocks of 1974 and 1979 along with high commodity prices in the international market also created a pressure on foreign exchange reserve. However, the sign of improvements observed in early 90s and crossed billion marks posted USD 1.6 billion in FY92. Except a declining trend during late 90s, the improvements continued along with the accelerated inflows of export earnings and workers’ remittances. In FY10, the reserve position crossed USD 10 billion mark that covered about four months imports. Further, reserve accelerated to USD 15.32 billion (equivalent of 5 months of imports) in end FY13 and reached to USD 21.56 billion at end FY14 (equivalent more than 6 months of imports).

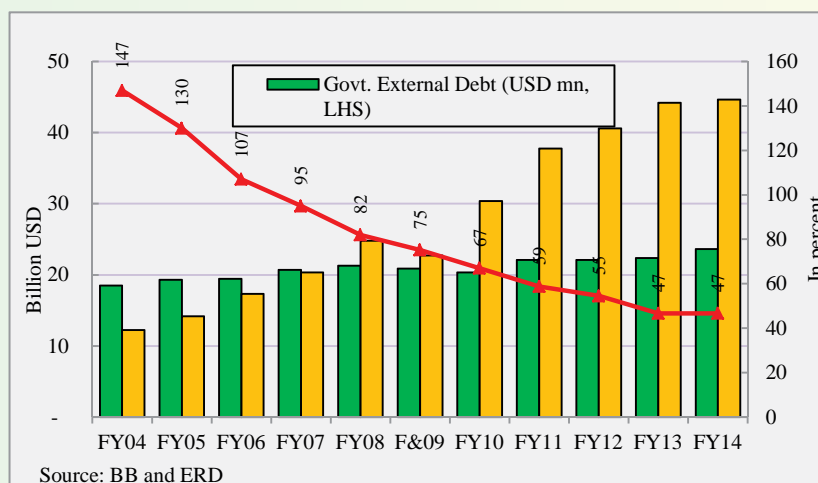
Chart 5: Foreign Exchange Reserve (in billion USD)



Government External borrowing and debt sustainability in Bangladesh: Significant reduction in debt ratios supports debt sustainability in the medium to long-term.

Bangladesh government possesses a favorable debt profile split between domestic and external debt to meet the deficit financing of the budget like some other countries. The Bangladesh Government’s external debt to GDP averaged 37 per cent during FY80 to FY00, reaching an all-time high of 45 per cent in FY94. The situation has improved gradually since then because of the adoption of different policy measures to improve overall economic activities. The debt to GDP ratio came down to 34 per cent in FY00 and onwards declined gradually and reached to at 16 per cent in FY14. In the same way, government borrowing from domestic sources has remained constant around at 11 per cent of GDP during last decade.

Chart 6: Government external debts and debt sustainability



External debt sustainability in terms of debt to current account receipts (CAR= export earnings plus workers’ remittances plus other foreign exchange receipts) ratio showed a significant improvement during last decade due to accelerated export earnings, remittance inflows and other receipts from abroad that build comfortable reserve. The ratio decreased to 47 per cent in end FY14 from 147 per cent in FY04 (Chart 6). The result of debt sustainability analysis (DSA) based on major macroeconomic developments and borrowing needs updated indicates Bangladesh remain at low risk of debt distress.

5. Findings: Openness and economic growth in Bangladesh

As discussed above, the trend analysis shows that economic openness significantly flourishes foreign exchange inflows through export earnings, remittance and FDI inflows that accelerated private sector. These factors directly promote manufacturing output growth that finally contributes to foster economic growth. Historical episode shows that

growth performance started to improve in the 1990s due to undertake several liberalization steps. In 1990s, the average GDP growth rate increased to 4.8 per cent from 3.3 per cent in 1980s. It turned to moderate at rate above 5 per cent during FY00 to FY05. Since FY04 GDP growth rate accounted above 6.0 per cent except a small declined to 5.9 per cent in FY09 due mainly to the adverse effect of 2008's financial crises and to political unrest in the country. However, the GDP growth performance is largely contributed by robust exports and strong increase in domestic demand led by strong growth performance in manufacturing industry, steady expansion in agriculture, and with major contribution from the service sector (which accounts for around half of the total GDP) that registered 6.1 per cent growth in FY14 (Chart 8).

Chart 7: Scatter plots of economic openness, and manufacturing output and GDP growth

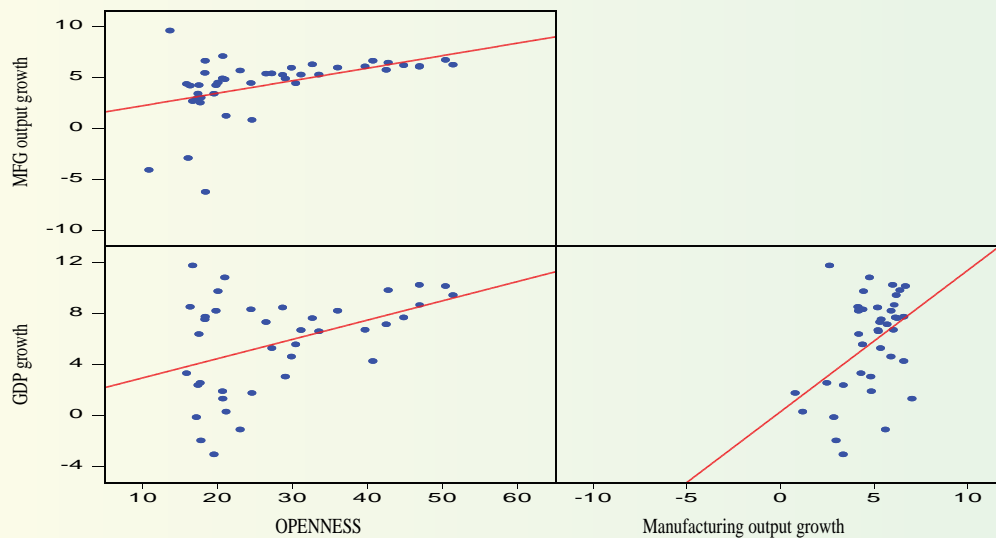
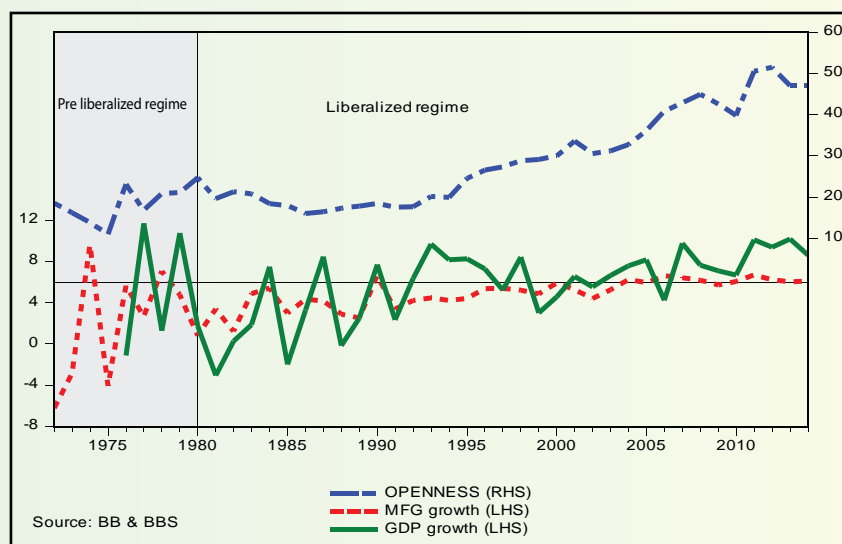


Chart 7 shows scatter plots and regression lines with the growth rates of GDP and manufacturing output, and economic openness index. The relationship between economic openness and manufacturing output growth, manufacturing output growth and GDP growth, and openness and GDP growth are elastic and positive. The relationship between manufacturing output and GDP growth looks highly positive, suggesting a strong interdependence between these variables particularly for a country like Bangladesh. Ready-made garments (RMG) occupy the lion-share in Bangladesh's exports. The RMG sector, in turn, is heavily dependent on the import of raw materials. Moreover, the import of capital good promotes exports of manufactured goods through the process of openness. Thus, the symbiotic relationship between exports and imports is expectedly positive. Thus,

the contemporaneous relation between manufacturing output and GDP growth appears to be strongly positive as shown in Chart 8.

Chart 8: Openness, and Manufacturing output-GDP growth rates of Bangladesh



In correlation analysis of these variables we find significant results. Table 3 presents the correlation coefficients of three variables- GDP growth, manufacturing output growth and economic openness which are positive and significant at 1 per cent level. The correlation coefficient with openness and manufacturing output growth is 61 per cent. The coefficient between GDP and manufacturing output growth is 0.44, and the correlation coefficient between openness and GDP growth is 0.43.

Table 3: Correlation tests:

Variable	Correlation coefficient	t-statics
Corr [openness, manufacturing output growth]	0.61***	4.637
Corr [Manufacturing output growth, GDP growth]	0.44***	2.963
Corr [openness, gdp growth]	0.43***	2.925

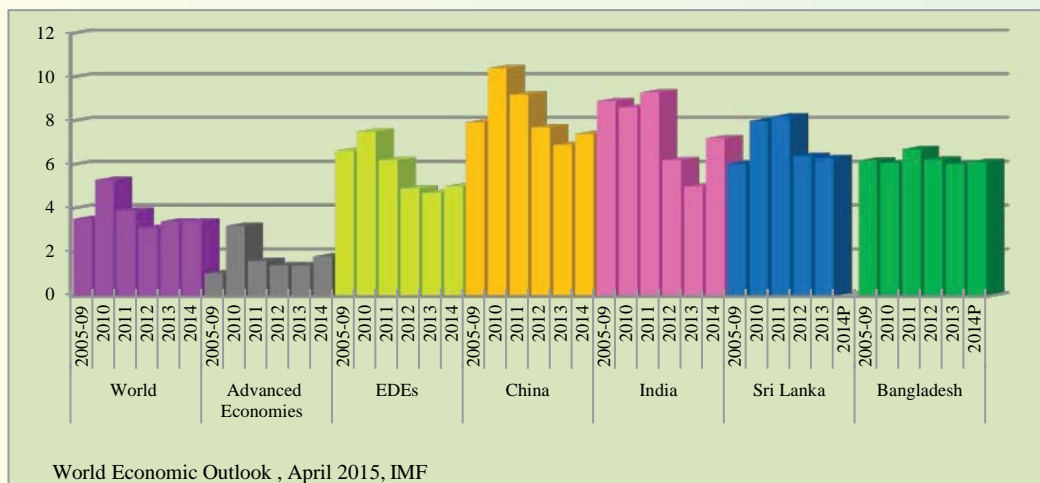
*** indicates the coefficients are significant at 1 per cent level

Openness and economic shocks

In the last three decades, a number of countries have opened their economies in terms of both trade and foreign exchange liberalization. Some of them have benefited from the initiative since they utilized and managed properly the inflows of foreign capital for their economic development that boosted domestic output and accelerated exports. Through this multiplier effect output growth increased. On the other hand, some countries had to face severe financial crises since they could not manage capital flows efficiently; the recent

crisis in India was caused by its failure to manage foreign capital flows adequately. Experiences from both sides have given remarkable lessons for countries like Bangladesh. Exchange rate policies of the crisis-ridden countries were not suitable since their currencies were overvalued so that foreign investors were able to leave local currency denominated assets.

Chart 9: GDP growth rate of selected economies: 2005-2014



However, during last couple of decade the world economy has experienced several crises. Interestingly Bangladesh was not affected remarkably by any of that crisis, including the recent past global financial crisis of 2008 due mainly limited capital account openness with the global economy. The currency turmoil of 1997 in East Asia caused substantial depreciation of exchange rates of East Asian currencies and also of currencies of neighboring India and Pakistan which were major trade partners of Bangladesh. In contrast, the depreciation of the currencies of those trade partner countries of Bangladesh helped the economy rather than hurt it because of cheaper imports because the Taka had appreciated against their currencies as Bangladesh has a huge trade deficit with them. However, financial markets and institutions in Bangladesh have remained free of the toxic assets and contagion afflicting the global financial markets over the past couple of years because of the limited, regulated external exposure of our economy. As a result, Bangladesh economy pass through with a stable growth rate over 6.0 per cent per year during last decade compare to any other developing economy (Chart 9).

6. Concluding Remarks

In this paper, we analyze the trends of major macroeconomic variables of Bangladesh with respect to different liberalization measures regarding economic openness. We find that in line with a number of developing economies and with the objective becoming a middle

income country by 2021, Bangladesh undertook several liberalization steps such as i) deregulation of import process by simplifying and rationalizing trade and tariff structure, cutting down tariff rates; ii) providing incentives for exports; iii) adoption of floating exchange rate management; iv) full current account convertibility of Taka; and iv) limited openness of capital account. These steps widened the country's international trade and increased participation of the domestic product in the world market. Thus, in terms of total trade, country's economic openness extended to 47 per cent in FY14 from 18 per cent in FY90.

The process ensured the availability of essential raw material and machinery for its domestic industry, increased FDI inflows and accelerated integration with the world economy. Through the forces of comparative advantage increased skills and factors productivity, and reduced production costs that led to increase country's economic scale. Resulted that flourished the manufacturing activities in the domestic economy and in turn the contribution of manufacturing sector to the GDP increases.

The trend of economic indicator of Bangladesh also shows that there prevails a stable exchange rate, single digit inflation rate, deepened and stable financial sector, increased remittances and FDI inflows, surplus CAB and comfortable foreign exchange reserve along with other macroeconomic fundamentals. Thus, Bangladesh became one of the Asian 'tiger-case' recorded more than 6 per cent GDP growth per year during last decade. Indeed, the country is now recognized as a 'trade dependent economy' and is no longer seen as an 'aid dependent economy'.

Recognized that, Bangladesh economy faces the challenges such as high cost of land, shortages of power and gas, lack of developed infrastructure (roads, highways, sea ports etc.) and political instability. However, government efforts continue to achieve the goal of making Bangladesh a middle-income group country by 2021 by overcoming the shortcomings discussed above.

Finally, we conclude by offering policy option that Bangladesh economy requires greater liberalization both in trade and capital account, and pragmatic policies to increase both domestic private and foreign investment to foster manufacturing output growth.

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