

Trade Liberalization, Growth and Poverty Reduction The Case of Bangladesh

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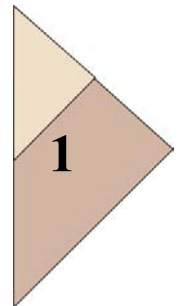
A. Background and Introduction

Few policy issues evoke as contentious a debate in developing economies as trade liberalization, openness and globalization. Critics comprising of politicians, labor unions, business and intellectuals see the world economy as inherently unequal, made worse by advocates of openness to trade and finance. Such openness allegedly exposes the poorer countries to the whims of the advanced countries who benefit more from this open access leading to unequal exchange and exploitation. Much of this debate is often fueled by perceptions rather than a careful review of the underlying analytical framework or empirical foundations. Like in other developing economies, this is a matter of lively debate in Bangladesh. A populist view is that trade liberalization and economic integration has contributed to inadequate progress with industrial development, and sometimes even leading to de-industrialization. Consequently, growth and employment prospects have suffered. Cheap imports have flooded Bangladeshi markets, making it impossible for domestic enterprises to grow and survive. This view prevails despite the fact that industrial performance under trade protection has been quite dismal. Critics also fail to recognize the gains to consumers and producers from access to lower cost consumer, intermediate and capital goods owing to greater trade openness. Not surprisingly, there is much less recognition that, despite major reduction in trade barriers since the mid 1980s, trade protection still remains a significant source of distortion in Bangladesh.

As compared with this populist view, what are the facts? Informing this debate with a good analysis of the analytical and empirical foundations of trade protection and the gains from trade openness will facilitate more informed debate on this major subject. This in turn would likely lead to support for further trade reforms. The objective of this research is to provide this analysis, drawing on the experience of Bangladesh and other relevant countries.

The paper will seek to compile evidence for the hypothesis that greater trade openness and associated other deregulation is good for growth and poverty reduction in Bangladesh. At the theoretical level, it can be argued that since Bangladesh is relatively heavily endowed with labor, within the framework of the Heckscher-Ohlin model (Ohlin, 1933; Heckscher, 1949) expansion of international trade opportunities will likely support the growth of labor-intensive export industries, promoting employment and incomes as per the Stolper-Samuelson Theorem (Stolper and Samuelson, 1941). More generally, arguments why greater trade openness is likely to contribute to higher growth and poverty reduction in Bangladesh might include:

- *Improved productive and allocative efficiency.* Unlike the protectionist regime of import substitution, trade openness will likely direct scarce resources into areas of Bangladesh's comparative advantage, promoting specialization and resulting in higher levels of output.
- *Factor accumulation and investment.* Trade liberalization will accelerate investment by allowing access to bigger markets, permitting scale economies, and encouraging imports of previously unavailable or cheaper capital goods and intermediate inputs.



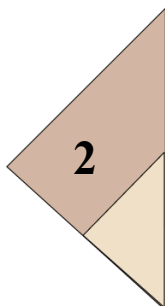
- *Knowledge spillovers.* Greater trade openness will produce knowledge spillovers through technical innovation that is embodied in traded goods and machinery as well as FDI.
- *Improved income distribution.* Open economies enhance the returns to a country's relatively abundant factor of production – unskilled labor, in the case of Bangladesh – thus augmenting real wages of unskilled labor, thereby contributing to improved income distribution.
- *Government policy improvements.* As the economy is opened up to global competition, there is greater pressure on policymakers to ensure macroeconomic stability and enhance deregulation.

The present paper will argue, using qualitative and quantitative analysis and a case study approach, that Bangladesh's increasing global integration based on trade liberalization and other economic deregulation, especially since the early 1990s, contributed significantly to the acceleration of per capita income growth and poverty reduction. This is not to suggest that trade liberalization alone was responsible for these positive developments. It is but only a necessary condition for removing the constraints to rapid growth. Other complementary measures that were taken, such as restoring macroeconomic stability, and removal of many burdensome controls on business and investment, provided the supportive policy environment for bringing about these outcomes.

The paper is organized as follows. Following the introduction above, Section B looks briefly at issues of trade openness and economic development from the theoretical perspective. Section C reviews the empirical basis for the effects of trade openness on economic development, drawing on relevant international experience of developing countries. In Section D we turn to the policy experience of Bangladesh since its independence in 1971, focused broadly on economic deregulation and trade liberalization. The implications of the various policy regimes, especially the impact of trade liberalization in the 1990s, are analyzed in Section E. Finally, the paper is closed in Section F with a few concluding observations.

B: Trade Openness and Economic Development: The Theory

The effects of international trade on development have been a subject of great debate for centuries. The classical economists believed free trade was an engine of growth while trade protection led to wasteful use of resources, thereby adversely affecting economic development. This advocacy for free trade was based not only on the famous Ricardian principle of comparative advantage but also on the belief that free trade would contribute to development through competition and learning (See Viner, 1937 for a classic review of the Ricardian theory). The free trade advocacy came under serious challenge only in the 1930s, as a run up to the employment problem faced during the Great Depression. The search for theoretical foundations to justify the use of trade protection for promoting development led to the formulation of the “optimum tariff” argument (Kaldor, 1940; Johnson, 1950). More broadly, the use of commercial policy to promote development in poor countries emerged as a new discipline, with arguments for protection ranging from infant industry protection, to responding to a terms of trade



deterioration, to the need to correct distortions in the domestic economy (The literature is large here but important work include: Myint, 1958; Lewis, 1954; Balogh, 1963; Prebisch, 1959; Singer, 1950; Myrdal, 1957).

In his classic exposition on the subject, Johnson (1958, 1971) argues that the advocacy for trade protection can be put under three groups:

- economic arguments;
- non-economic arguments;
- and non-arguments.

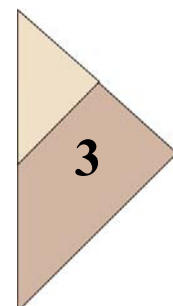
Economic arguments are those that seek to increase real income through trade protection. These include infant industry argument, the optimum tariff argument and arguments related to external economies or correction of domestic market distortions. **Non-economic arguments** relate to the achievement of certain social goals that may or may not result in higher real incomes. These include arguments for self-sufficiency or the need to develop a minimum level of industrialization to satisfy national pride. **Non-arguments** are essentially those based on inadequate analysis or understanding of the underlying issues. These include the belief that there is evidence of a secular deterioration in the terms of trade of primary producers and therefore this should be offset by protection to promote industrialization, or the belief that the balance of payments problem needs to be resolved through trade protection.

The economic arguments for protection have been extensively reviewed in the literature. Johnson has summarized the main conclusions as follows:

- first, the only valid proposition for tariff protection is the one based on the optimum tariff argument; other arguments for protection are arguments for subsidy.
- And second, the use of tariff in other cases can lead to further distortions.

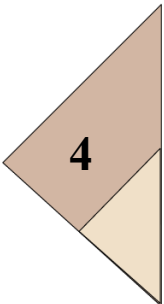
The first conclusion follows from the standard theory of welfare economics that a distortion in trade markets can only be corrected through a trade intervention; distortions in the domestic economy need domestic instruments (taxes/subsidies). The second conclusion is based on the general theory of the second best that postulates that a priori correction of one distortion may or may not lead to welfare improvement as it introduces another distortion (Lipsey and Lancaster 1958).

Given this remarkably weak theoretical underpinnings for protection, one might wonder why has the subject of trade protection gained such political support, particularly in developing countries. One major reason for this is the implications of free trade for income distribution. While gains from trade is Pareto optimal in the sense that it expands the utility possibility frontier, given the same production possibility frontier as under autarky, and can potentially make all parties well off, this does have implications of income distribution effects. Thus, a country may not in practice be able to design and implement the concerned welfare maximizing transfers whereby gainers are able to effectively compensate the losers and yet everybody still emerges as gainers (see Findlay 1970, for an easy to read summary of the theoretical underpinnings of the trade and welfare issues).



The effect of trade on income distribution has been the subject of intense discussion in the literature. The most well known analytical framework is based on the work of Paul Samuelson and Wolfgang Stolper, also known as the Stolper-Samuelson Theorem. Working in the context of the Heckscher-Ohlin model with two factor inputs (labor and capital) and two goods, the theorem demonstrates that a move from a situation of no trade to free trade will reduce the return to the relatively scarce factor. Hence, a tariff, by raising the price of the good employing intensively the relatively scarce factor, will tend to benefit the relatively scarce factor. Surprisingly, though, critics of free trade have missed the point that tariff would tend to benefit the scarce factor more. In developing countries, in most cases labor appears to be a relatively more abundant factor while capital is the relatively scarce factor. So, under the framework of the Heckscher-Ohlin model of trade, tariff will likely benefit the capitalists at the expense of labor! Trade liberalization, on the other hand, is likely to benefit more the labor intensive enterprises, contributing to more employment and higher incomes, rather than hurt the labor group as a whole².

Indeed, theory explains quite well why the owners of capital in Bangladesh (owners of large-scale enterprises) are strongly opposed to trade liberalization. What is paradoxical is that even labor unions are opposed. This might be because liberalization, by pushing competition, hurts workers in the protected public enterprises and private enterprises that are unable to adjust to increased competition in a lower tariff regime. These workers also tend to be more organized and militant. Thus, it is important to recognize the complexities in the real world which, more often than not, is a departure from the simple 2-factor 2-commodity model of H-O.



C. Trade Openness and Economic Development: The Empirical Evidence

The effects of trade openness on poverty reduction have been studied in great length in the literature. Bhagwati and Srinivasan (2001) proposed a useful approach to trace the effects of trade openness on poverty from two perspectives:

- A static or short-term perspective, where the main influence emerges from the direct effects of trade liberalization on employment and real wages of unskilled workers (Stolper-Samuelson effect);
- A dynamic perspective that looks over the longer term effects of trade liberalization on economic growth, employment and real wages over time.

The inability to take this holistic look has often contributed to the confusion in judging the effects of trade liberalization on economic development.

Evidence on Short-term Effects on Real Wages and Employment: Empirical verification of the Stolper-Samuelson (SS) Theorem has been complicated by the facts that: a) there may be more than two factors of production; (b) labor is not a homogeneous category (skilled versus unskilled labor); (c) there may be substantial labor market distortions (minimum wages, unionization; other constraints on labor mobility); (d)

² The limitations of the Heckscher-Ohlin model and the associated factor price equalization theorem are well known and a good review can be found in Johnson (1957). For the purposes of this paper, the broader implications of the Stolper-Samuelson theorem are still very much relevant (i.e. that trade tends to benefit more the relatively abundant factor).

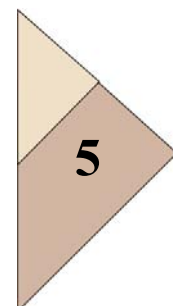
separating the effects of trade from factor mobility; and (e) longer-term versus shorter-term effects. Empirically identifying the SS effect is fraught with analytical and empirical difficulties. Analysis of SS in realistic multi-factor (more than two) models are not easy to formulate in an empirically testable fashion. Also, the SS mechanism works through changes in domestic relative prices brought about by trade liberalization. However, in reality, trade liberalization is often accompanied by other changes, such as in the exchange rate and domestic taxes that could mute the effect of trade liberalization on domestic prices.

Given these concerns, it is hardly surprising that research has often found evidence of 1) greater wage inequality; and or 2) declining real wages of unskilled labor; and 3) reduction in employment, following trade liberalization (Beyer and Vergara 1999; Borgas, Freeman and Katz 1997; Leamer 1996; Rama 1994; Slaughter 1999; and Wood 1995). Typically, unskilled labor will lose if product prices of goods that require relatively more intensive use of such labor falls. This would happen if there is a surge in the import of such goods after liberalization or if there is a significant inflow of unskilled workers from neighboring countries due to liberalization of immigration. However, even in this case the static effects are at best partial as they ignore the positive effects on the poor from falling prices (and inflation) in their role as consumers. As well, rising wage differential could still be associated with growing overall employment and increasing wages for both skilled and unskilled workers. For example, Stern and Dreze (2001) found that agricultural real wages in India grew by 2.5% p.a. in the post trade liberalization period of the 1990s, although GDP grew faster.

Using Computable General Equilibrium (CGE) type models, several studies have shown that trade liberalization would increase the welfare of the poor in general (Devarajan and Van der Mensbrugghe, 2000; Friedman, 2000; Cranfield, Hertel and Preckel, 2000); Ianchovichina, Nicita and Soloaga, 2001). Bhagwati and Srinivasan (2001) also point out that a country that wishes to promote greater trade openness is likely to maintain macroeconomic stability. The resultant outcome of low inflation would benefit the poor. For example, Ravallion and Datt (1999) find direct evidence that lower inflation reduced poverty in India.

Evidence on Trade Openness and Growth: The most compelling argument for greater trade openness comes from the effects of this on economic efficiency, which promotes private investment and economic growth. Higher growth in turn helps lower poverty by increasing employment and real incomes of the poor. In an influential paper, Krueger (1998) summarizes the reasons why trade liberalization is good for growth.

- Developing countries have production patterns that are skewed towards labor-intensive service, agriculture and manufacturing. People have low per capita incomes and markets in such countries are usually small. A liberalized trade regime allows low-cost producers to expand their output well beyond that demanded in the domestic market
- Whereas industrialization based on protection of domestic industries thus results in even-higher capital intensity of production, the open trade regime permits enjoyment of constant returns to scale over a much wider range.
- Import substitution regimes normally give bureaucrats considerable discretion either in determining which industries should be encouraged or in allocating scarce foreign exchange in a regime of quantitative restrictions, leading to serious efficiency losses. On the other hand, open trade regimes force greater reliance on the market.



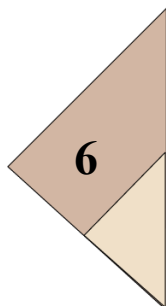
Empirical evidence on the positive effects of trade openness on growth is quite abundant (Dollar, 1992; Frankel and Romer, 1999; Dollar and Kaaray, 2001; Bhagwati and Srinivasan, 2001; Wacziarg, 1998) although there are some critics who dispute these findings on methodological ground (Rodrik, 1996; Rodriguez and Rodrik, 1999). Even so, Rodriguez and Rodrik caution that their main intention is to challenge the over-enthusiasm on the questionable outcomes of many research showing strong positive correlation between openness and growth rather than to convey the message that they think trade protection is good for growth. Indeed, they admit that they are not aware of any credible evidence, at least for the post 1945 period, which suggests that trade restrictions are systematically associated with higher growth rates.

The most well-known recent study that provides evidence on trade liberalization, growth and poverty reduction is that of Kaaray and David Dollar (2001). The study concludes that a third of the developing countries of the world, described as “rapid globalizers”, did extremely well in terms of income growth and poverty reduction over the past two decades or so. These countries, which include Bangladesh, India and Sri Lanka in South Asia, have experienced large increases in trade and significant reduction in tariff and non-tariff barriers. Bangladesh, for instance, saw its trade GDP ratio almost double (during the course of the 1990s decade). In contrast, the remaining two-thirds of the developing world, with a large concentration in Africa, that did not experience trade expansion due to a lack of sufficient outward orientation, performed poorly both in terms of growth and poverty reduction.

Other studies look at the relationship between openness and growth, the presumption being growth is good for the poor. Thus, Wacziarg (1998) investigates the links between trade policy and economic growth using data from a panel of 57 countries from 1979-89. The results suggest that trade openness has a strong positive impact on economic growth. Similarly, Frankel and Romer (1996) using cross-country regressions conclude that trade has a quantitatively large, significant and robust positive effect on income. Dollar (1992) examines sources of growth in 95 developing countries during 197-85 and finds a strong positive correlation between a measure of outward orientation and per capita GDP growth. Bhagwati and Srinivasan (2001) point out that practically no country that has been close to autarky has managed to sustain a high growth performance over a long period. Five decades of development experience has shown that being open to external trade and investment flows allows a developing country to grow faster economically than otherwise and that faster economic growth is an effective and efficient means for alleviating poverty.

Perhaps the most useful insight on the effects of trade liberalization comes from a review of country experiences. These also dispel any nagging doubts about the robustness of results emerging from cross-country regressions. Amongst the well known examples of how trade liberalization has contributed to growth and poverty reduction include Chile, China and India. These country examples are discussed in some detail in boxes 1, 2 and 3.

Chile liberalized the trade regime unilaterally over the 1974-2000 period. Chile initially suffered from adjustment costs in terms of loss of employment in protected sectors. However, between 1985-2000, Chile grew by almost 7% per annum and inflation declined to around 6% p.a. Importantly, Chile was able to cut poverty by more than half between 1987 and 1998 (see Box 1).



China's trade liberalization policy started in late 1978. Within the pace of 20 years, China became one of the most open economies in the developing world with the GDP share of trade growing from only 11% in 1978 to over 40% in 1998. Average GDP grew by over 7% per annum and exports by 20 % per annum. Although there has been rising income inequality, poverty fell at a rapid pace with the incidence of poverty declining from 30% in 1978 to less than 15% in 1998 (see Box 2).

Box 1: Chilean Trade Liberalization

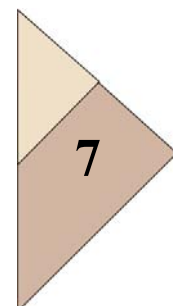
Chile serves as a model for reforming economies throughout the world as to how trade liberalization affects the economy. When first implemented, the measures were openly criticized for their adverse effects on unemployment; however, now the success of the reforms been recognized - - economic growth has averaged almost 7% per year during 1985-2000, the annual rate of inflation has declined to around 6% and unemployment is just over 5% of the labor force. Poverty has been cut by more than half, between 1987 and 1998.

Chile launched its liberalization program in the early seventies, amidst radical political transformation from a democratic system to a military dictatorship. Its policies can be divided into five stages, each featuring different compensation schemes, used to raise support and reduce opposition to the reforms. In the first phase (1974-78), there was a dramatic reduction and simplification of trade barriers -- by 1979, the average tariff had been cut down to 13.6% from its original level of 105%. This was also accompanied by depreciation of the real exchange rate by almost 150%. In the second phase (1979-82), there was a significant real exchange rate overvaluation, which led to a balance of payments crisis in 1982 -- firms and banks went bankrupt, unemployment soared and GDP declined by over 14%. The third phase (1983-85) is characterized by a temporary reversal in policy, where price bands were re-introduced and the tariff was raised to 35%. Liberalization resumed in the fourth phase (1985-90), with tariffs being cut again and an independent central bank established. Furthermore, the government returned to a democratic system. The fifth phase, which continues at present, incorporates further tariff cuts as well as preferential trading agreements, high capital inflows and strong economic growth.

Much of the criticism of the liberalization program has been focused on its effect on employment. Critics argue that the speed of breaking down the protective structure forced firms into bankruptcy and lead to escalating unemployment. However, numerous reforms were taking place simultaneously, thus it is hard to distinguish the effects of trade liberalization from those of other policies. On the other hand, a recent survey using unemployment data at the micro level concludes that the degree of liberalization positively affects the probability of being unemployed as well as the duration of unemployment, whereby individuals in the affected sectors experienced longer unemployment spells. However, these results must be interpreted cautiously due to the inability to separate the effects of trade reform from other policies.

Importantly, as mentioned before, in recent years, economic growth has picked up rapidly, inflation has fallen, unemployment rate is low and stable, and poverty has declined by 50%. Supportive government policies to spread the benefits of economic integration to the poor has included: unemployment insurance, housing subsidies for low-income households, child care and income support for the poor.

Source: Edwards, S. and Daniel Lederman. "The Political Economy of Unilateral Trade Liberalization: The Case of Chile", NBER Working Paper No. w6510. April 1998.



Box 2 China and Trade Liberalization

A thriving market economy has helped lift China out of poverty. China has successfully transformed from a closed economy to an open economy. The degree of openness of the economy, which is calculated by trade against GDP, is strikingly rising from 11% in 1978 to 50% in 2000. As a result of open-door policies and reforms, its relationship with the rest of the world has been transformed and its modernization and growth have accelerated. According to a projection scenario, China's share in world trade could triple more than 10 percent, making it a major engine for growth for world trade. China would become the second largest trading nation in the world.

The pace of global integration—the widening and intensifying of international linkages in trade, investment, and finance—has accelerated since the mid 1980s. The increase in China's trade to GDP ratio—from 10 percent in 1975-79 to 36 percent in 1990-94—was the seventh most rapid among 120 countries. And the increase in its foreign direct investment (FDI) to GDP ratio—from almost zero in 1975-79 to about 3.5 percent in 1990-1994—was the sixth most rapid. Its foreign trade currently ranks the 11th in the world. The increase in trade openness between the two periods 1.7 percentage points a year—was the seventh most rapid in the world.

Over the past twenty five years China's GDP growth averaged 10 percent a year. This rapid pace of growth has allowed China to secure major progress in reducing poverty. Indeed, China's record on reducing poverty is enviable. Since reforms started in 1978, China has lifted some 200 million people out of absolute poverty. Most of this progress occurred in the early years of reforms, when the introduction of the household responsibility system transformed China's country side. In the mid-1980s and early 1990s poverty levels stagnated despite gains per capita per GDP. Since 1992, however, poverty has declined markedly, and at the end of 1995 less than 6 percent of the population had incomes below the absolute poverty line.

China's expected growth of about 7 percent a year over the next twenty-five years will magnify its presence in the world economy. China will account for some 40 percent of the increase in developing country imports between 1992 and 2020, helping to drive growth in world trade. Rapid growth has been driven by the same basic factors in China as it has in all East Asian economies; high rates of investment, financed by high domestic savings; increases in education spending; and abundant labor and its growth. In the post reform period market driven investments and has been deployed more efficiently as labor became more responsive to market forces, savings have responded to profitable investment opportunities, and human capital moreover, foreign trade and investment have played a bigger and more efficient allocative role in the economy.

Since the 1980s the development strategy has been oriented towards export-led industrialization. The focus of public investment and fiscal initiatives was deliberately shifted in favor of the coastal growth poles by providing special privileges, incentives, and investment allocation to coastal provinces and cities, including the permission of greater retention of local tax and foreign exchange revenues and greater freedom to use expansionary bank loans for local investment.

Source: *China 2020: Disparities in China: Sharing Rising Incomes*, The World Bank, Washington D.C. 1997; *China 2020: Integration with the Global Economy: China Engaged*, The World Bank, Washington D.C. 1997; Jun Ma. *China's Economic Reform in the 1990s*, World Bank, January 1997; Amei Zhang. *Poverty Alleviation in China: Commitment, Policies and Expenditures*, The World Bank, Washington D.C. 1999

India is yet another example of how economic liberalization including trade liberalization spurred growth of exports, investment, income and contributed to poverty reduction. Compared with the famous 3% per annum so-called hindu growth rate over the 1950-80 period, India's GDP expanded at almost double the pace between 1980-2000,

fueled by economic deregulation and trade liberalization. Trade to GDP ratio grew from only 10% in 1980 to 25% in 2000. Poverty declined substantially, falling from 45% in 1980 to 26% in 2000. The progress with poverty reduction continued in the 1990s despite evidence of growing income inequality (see Box 3).

Box 3: Trade Liberalization and Poverty Reduction in India

India has undergone significant trade and other economic liberalization in the past two decades. Starting in 1984, trade liberalization gained momentum in the 1990s. Prior to this, the trade and exchange rate regime was characterized by a generally high level of protection. High tariffs, quantitative restrictions (QRs), export controls and hostility to foreign investment were the main policy instruments used.

Especially since the reforms of 1991, a significant shift away from the inward strategy towards an outward orientation took place. Initially the reform involved a significant devaluation of the rupee, removal of QRs on imports (except for imports of consumer goods and agricultural products), and a reduction of tariffs and their dispersions across the board. The exchange rate was unified and made convertible on the current account in 1993. Relaxation of restrictions on inflows of foreign capital (FDI and portfolio) led to a surge in inflows (and an appreciation of the rupee) for a while. Thus compared to the highly restrictive trade, payments, and capital flow regime that characterized India for more than four decades, the post 1991 regime represents a radical change that is far more liberal.

India has achieved significant reductions in poverty during 1980-2000, some of which was the consequence of rapid growth driven by India's increasing trade openness that brought productivity gains. According to the World Bank (2000) estimates, real GDP grew at an annual average rate of 6% during these two decades, as compared with a meager 3% per annum during the 1950-80 period. Fewer than ten countries exceeded the Indian growth rate. The effect of growth on poverty reduction in India was dramatic. By the Government of India's (2000) estimates, poverty incidence fell from 51% in 1977-78 to 27% in 1999-2000. Much of this growth came in an era of rapid trade liberalization.

The gains from trade liberalization was pretty broad-based. Among the success stories include the software and gems and jewelry. These are now among India's largest export earners. Another activity that has benefited is the machine tool industry, which converted from a high-cost enterprise under heavy protection to an efficient and competitive enterprise following liberalization of 1991. Even agriculture has benefited from trade reforms, reflected in improvement in terms of trade, output growth and increase in farm real wages.

Source: T.N. Srinivasan. *Integrating India with the World Economy: Progress, Problems, and Prospects*, Draft, November 2001; Jagdish Bhagwati and T.N. Srinivasan. "Trade and Poverty in the Poor Countries", *American Economic Review*, December 2001; Nicholas Stern. "Making Trade Work for the Poor", Speech Delivered at NCAER, Delhi, November 2002.

These diverse country examples are a reassuring sign that trade liberalization can be used as a positive force to push economic growth and reduce poverty. Of course, there are other associated factors that have helped secure this progress. Invariably, private investment has increased in response to better investment climate and incentives. Supportive government policies in terms of investment in basic social services and infrastructure have helped. Attention to rural development and agriculture (in China) was an important determinant of poverty reduction. As well, generally sound macroeconomic policies kept inflation low and real exchange rate at a competitive level. But the main point is that in all these cases there was a significant departure of policies from inward looking import substituting industrialization strategy to an outward looking export promotion strategy. Overall policy framework, including macroeconomic management,



exchange rate management and other policies, were supportive of this outward orientation.

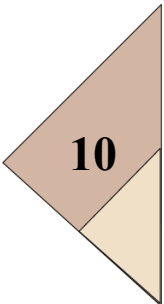
There are also interesting differences in country experiences that have important bearing on the design of outward-oriented public policy.

- Both China and Chile gained tremendously from inflow of direct foreign investment following economic liberalization. Thus, the volume of DFI in China surged from only \$5 billion in 1978 to \$40 billion in 1998. In Chile, this grew from \$0.2 billion in 1974 to \$3.5 billion in 1998. But, in India the role of DFI has been very modest, growing from \$1 billion per annum in 1980 to \$3.5 billion in 2000. This is largely because supportive reforms (“behind the border reforms”) to enable trade liberalization to work fully have been lagging behind significantly as compared with Chile and China. Consequently, the investment climate for doing business remains less conducive in India as compared with Chile or China (Dollar and Goswami, 2001).
- The pace and magnitude of trade liberalization have been lower in India than China and Chile. India’s tariff level is still quite high relative to the average for other developing countries. As well, other forms of trade protection, especially anti-dumping, is hurting the growth of trade in India (World Bank, 2002). Consequently, the lost opportunity in terms of greater gains from trade has been large in India (Stern, 2002).
- Growing income inequality was seen in China and India along with trade liberalization and rapid growth. Interestingly, however, growth has been relatively more pro-poor in China than in India (Ravallion, 2002). This suggests that there is scope for improving public policy to support more rapid poverty reduction in both countries, especially in India, by putting in place processes and policies for the disadvantaged to catch up.

Summary of International Evidence on Trade openness, Growth and Poverty:

The above analysis provides strong evidence that greater trade openness is good for growth and poverty reduction over the longer term. It also suggests that there may be short term costs in terms of falling real wages of unskilled labor and or initially declining employment as greater competition drives out inefficient firms from business. Although these transition costs do not represent a credible case against trade openness, as the longer-term benefit would invariably offset these short-term cost, they need to be tackled through proper compensatory policies aimed at mitigating such costs. This is particularly important in order to manage the political economy of reforms. Since the loss is almost immediate while gains are more longer-term, losers are likely to have a strong vested interest to fight the change. Additionally, in many cases, these losers are a strong political force and can provide formidable opposition to change.

Research provides considerable insights on how such compensatory policies could be formulated (Bannister and Thugge, 2001; Dante, 2001; Cranfield, Hertel and Preckel, 2000; Edwards and Lederman, 1998; Harrison and Tarr, 2001). Also, as Winters (2001) has rightly pointed out, these trade-offs and associated mitigation measures need to be tackled on a case-by-case basis because individual country circumstances will likely be quite different.



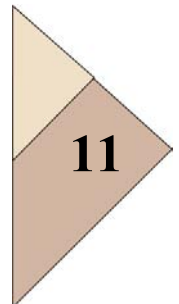
D. Trade Openness and Economic Deregulation in Bangladesh

Overview

Since independence in December 1971 and until late 1975, Bangladesh followed a development strategy of state intervention and controls (Ahmed, 2002). This first phase was characterized by massive nationalization of most production entities, heavy trade controls, and other forms of state interventions as Bangladesh experimented with a socialist type economic framework. An early phase of economic deregulation and denationalization started in 1976, although it took some years to have a clear direction for this to work out. This second phase ran up to 1990 with a mix of denationalization, economic deregulation encompassing both goods and services sector, and limited trade liberalization. The third phase, starting in 1991, saw continued progress with deregulation and privatization but most importantly witnessed fairly rapid trade liberalization compared to the past. The main elements of this analytical framework are summarized in Table 1.

Table 1: Bangladesh Policy Regime Summary 1972-2002

Reform Content	Phase 1 (1972-75)	Phase 2 (1976-90)	Phase 3 (1991-02)
Trade	Severe trade controls on both exports and imports, including NTBs and heavy duties, often prohibitive.; fixed exchange rate system, with considerable over-valuation.	Initial phase of trade reforms with some relaxation of NTBs and tariff barriers; creation of enabling “free trade” environment for garments sector (bonded warehouses, duty-free inputs, etc)	Substantial liberalization of trade and investment, market orientation, and opening up with large reduction in NTBs and average tariffs; shift from fixed to moderately flexible exchange rate system.
Goods Sectors	Massive nationalization of major industrial enterprises; price controls; control of agriculture inputs and marketing..	Initial period of denationalization, deregulation and removal of price controls; significant liberalization of agriculture sector – input and output markets.	Further progress with privatization of manufacturing enterprises; initiation of deregulation measures to improve the investment climate for private enterprises.
Services Sectors	Nationalization of most services including banking, infrastructure and even trading; administered prices.	Initial period of encouraging private sector in banking and other services; rent and price controls lifted substantially; state trading abolished, with one exception, TCB, for imports of sugar, fertilizer and rice.	Further progress with policies to support private investment in banking and infrastructure; power generation, telecommunications, opened to private investors.



I: Progress With Trade Liberalization

Phase 2 noted above saw the beginnings of a move towards greater market orientation of economic policies. The New Industrial Policy of 1982, which began the de-nationalization process, was followed up by some modest downward adjustment of tariffs and QRs. A ‘free trade enclave’ was constituted for the emerging readymade garments (RMG) industries through the introduction of bonded warehouse facilities and back-to-back LCs that were the conduit for duty-free imports of inputs. Subsequently, there was significant liberalization in the import regime of agricultural inputs and implements. Notwithstanding these liberalization measures, the overall trade regime remained heavily protected. Thus, for example, the number of items on the import control list due to trade protection reason remained as high as 215 (21.1 %) even as late as 1991 (see Table 2). Similarly, the maximum tariff was at 350% in 1990 and average tariff (unweighted) was at 100% in 1985, falling to 57% in 1992 (see Table 3).

The major progress in trade policy reform came in the Phase 3 starting in 1991 with a substantial scaling down and rationalization of tariffs, removal of trade-related QRs and elimination of import licensing, unification of exchange rates and the move to a more flexible exchange rate system. In 1994, Bangladesh conformed to the IMF’s Article VIII, making most current account transactions convertible. Unfortunately, by the middle of the 1990s, trade reforms slowed, and was even reversed somewhat during the last years of the decade, on the popular notion that earlier reforms had been ‘too much too fast’.

Outward orientation in Bangladesh, particularly since 1991, has covered, *inter alia*, three major areas:

- Liberalization of imports through removal of quantitative restrictions (QRs);
- Reductions in nominal and effective tariffs; and
- Adoption of a unified and moderately flexible exchange rate regime.

It should be noted that, in contrast to the piecemeal and partial reforms of the 1980s, liberalization of Bangladesh’s trade regime since 1991 was more systematic and comprehensive. The overriding objectives of these policies were to promote competition and achieve neutrality of incentives between production for exports and import substitutes, while gradually making trade facilitation the centerpiece of customs administration.

Liberalization of imports: The liberalization of imports was done primarily via removal of QRs in phases (see Table 2). Significant progress was made in removing QRs, as compared with the 1980s, to the point where a small but sensitive list of items remain restricted, mostly for non-trade reasons. Whereas nearly 26% of all HS-4 digit codes were subject to QRs in 1990, now only 122 items (or 10% of items) covering about 2 percent of imports remain restricted, for trade and non-trade reasons. However, the progress towards increasing liberalization that was evident up until the Import Policy Order of 1995-97 seems to have been halted – even modestly reversed – in the IPO 1997-2002. Overall, since 1990, trade-related QRs have been progressively removed, leaving some 2.2% of total HS 4-digit tariff lines (and 0.5% of import value) subject to trade-related prohibitions or bans as of 2002. These restrictions are now limited to only three categories: agricultural products (chicks, eggs, salt), packaging materials, and textile

products. Nearly 40% of all QRs apply to textile products that enjoy the heaviest protection. Although the readymade garment sector imports woven fabrics and grey cloth duty-free under bonded warehouse facilities, the system is cumbersome and susceptible to corruption (through leakage into the protected domestic market).

Table 2: Phased removal of import restrictions

	IPO 1987-91	IPO 1991- 93	IPO 1993- 95	IPO 1995- 97	IPO 1997-02
Number of items in the control list at the HS 4-digit level	315 (26.1%)	193 (15.6%)	111 (9.0%)	120 (9.7%)	122 (9.8%)
Number of trade-related items in the control list at the HS 4-digit level	253 (21.1%)	79 (6.4%)	19 (1.5%)	27 (1.9%)	27 (2.2%)

Source : Ministry of Commerce. Import Policy Orders for various years.

Some of the remaining ban/restriction on imports is on grounds of health, religion, environment, culture and so on. Yet, a review of all the items in this group reveals that many of the prohibitions or restrictions cannot be justified on these grounds and are presumably included for protection purposes. Thus, in the interest of economic efficiency and predictability of impacts, at a minimum, it would still be more meaningful to replace the QRs with equivalent tariffs.

Quasi QRs. Although import licensing was abolished early in the 1990s leading to the near demise (albeit incomplete) of the office of CCIE (Chief Controller of Imports and Exports), sundry permits, clearances and approvals are still required for specific imported products, quite apart from the standard LCA. The net effect of these procedures is akin to import licensing. Furthermore, administrative procedures designed to manage QRs are equivalent to “non-automatic licensing” that implicitly places ceilings on imports of certain products. Another procedure that could effectively serve as a barrier to imports is the requirement for registration of importers. The registration fee itself is unlikely to constitute a significant barrier, but the need to register involves a costly layer of bureaucracy with clear potential for obstruction and abuse.

While all the above steps helped remove anti-export bias of the trade regime, export expansion, especially the spectacular growth of the readymade garment sector, would not have been possible without the supplementary facilitating policies such as Special Bonded Warehouse, Duty Drawback and back-to-back LCs, all of which helped ensure world-priced inputs to exporters.

Tariff Rationalization: During the 1990s, Bangladesh significantly reduced its tariff rates and rationalized the structure, progressively moving towards the goal of simplicity and transparency of customs tariff. The top CD rate came down from 350 percent in 1990 to 32.5 percent today (see Table 3). The average (unweighted) customs duty declined to 17% in FY02 as compared with 57% in FY92, and 100% in 1985. Considerable rationalization of the tariff structure occurred and progress was made towards achieving a degree of uniformity and removing some tariff anomalies that existed due to higher tariffs on intermediates than final products (see Table 4).

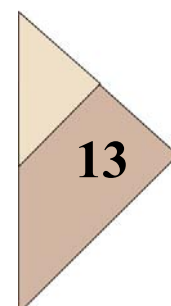


Table 3: Progress in tariff rationalization

Tariffs	FY92	FY96	FY97	FY02	FY03
Average CD (unweighted)	57	22	22	17	16.5
Average protective tax	61	74	26	27	22
Top CD rate	350	50	45	37.5	32.5

Table 4: Summary Indicators of MFN tariffs in Bangladesh, 1992-2003

Indicators		1991/92	1996/97	2002/03
01.	Percentage of Bound tariff lines	0.0	13.2	13.2
02.	Percentage of Duty free tariff lines	4.08	14.70	15.36
03.	Un-weighted avg. of customs duty	57.23	21.87	16.51
	Agricultural products (HS Ch 1-24)	71.80	28.86	23.35
	Industrial products (HS Ch 25-97)	55.62	20.76	15.08
04.	Standard deviation of CD	40.85	16.22	11.64
05.	Un-weighted avg. of all import taxes	82.57	39.08	35.51
06.	Avg. collection rates (all imp taxes)	37.41	34.39	na
07.	Avg. protective tax	60.92	25.66	22.04
08.*	Percentage of lines with International tariff "spikes"	79.87	52.55	42.47

* Percentage of tariff lines with CD>15.0.

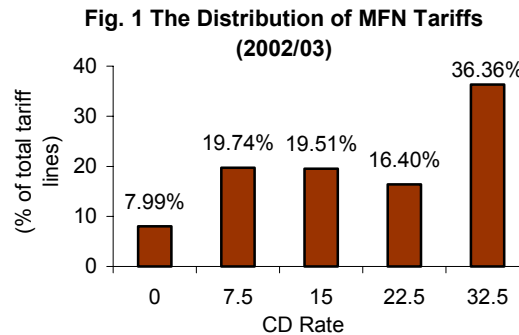
Notwithstanding this progress, there is still a substantial way to go forward with further tariff rationalization. First, the application of various levies, surcharges, supplementary duties on imports (and even VAT applied discriminatingly against imports) resulted in an average nominal protection of 27% in FY02, well above the protection afforded by customs duty. Lately, more than a third of the protective effect came from these para tariffs. In fact, there was a modest increase in average nominal protection since the mid-1990s in contrast with the sharp decline experienced since 1991/92. Second, the level of effective protection afforded by the tariff structure is influenced by the level of average tariffs as well as its dispersion. Since both these indicators have shown a substantial downward trend since 1991, the presumption is that the effective rate of protection (ERP) has also declined over the years. However, enterprise level effective protection estimates are not available for a long period, except for FY02. The fact that the average ERP, at 78% in FY02, is significantly higher than the average nominal protection of 27% suggests the existence of tariff escalation (Table 5), whereby average applied tariffs on basic raw materials (11.3%) and intermediate goods (11.9%) are substantially less than that of final consumer goods (25.6%)³. Furthermore, there is wide variability in ERP across sectors, ranging from 23% for manufacture of machinery and equipment to 258% for chemical and chemical products. Also, it is worth noting that although Bangladesh has moved in principle to the WTO's transactions value system, in practice discretionary valuation practices leave room for further protection and unpredictability of transaction costs.

³ Review of Relative Protection 2002, Bangladesh Tariff Commission.

Table 5: Tariff escalation in Bangladesh, 2001-02

Indicators	Un-weighted Customs duty	Customs Duty collection rate	Un-weighted Total Taxes	Collection rate, all taxes
Basic Raw Material	11.26	9.27	27.95	18.74
Intermediate Products	11.93	9.22	30.61	23.44
Final Consumable Goods	25.56	12.08	56.96	28.16

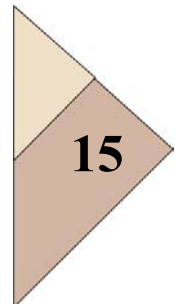
Finally, other notable features of the tariff structure that could lead to potential loss of efficiency and possible abuse of the system are: tariff concessions granted by end-use, existence of multiple rates for similar products (at HS 4-digit level), and rise in zero rates. Fig.1 gives the distribution of MFN tariffs for current fiscal year (FY03).



Exchange liberalization: As in the case of trade liberalization, following the difficult period of 1972-75, exchange rate management improved gradually and by and large the adverse effects of overvaluation were avoided for most of the period since then. However, exchange rate reforms gained momentum in the 1990s. Importantly, the multiple exchange rate regime was replaced by a unified exchange rate in 1992 and the flexibility of the exchange rate system was enhanced to strengthen the competitiveness of exports. In 1994, the Taka was made convertible for current account transactions.

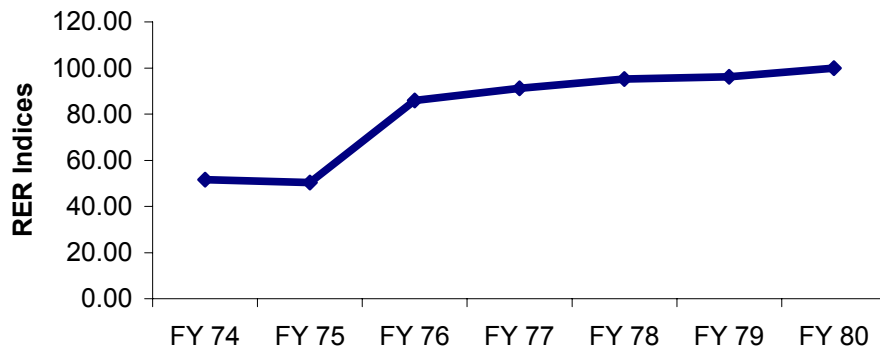
Trends in Real Effective Exchange Rates (REERs): Compared with India and Pakistan, Bangladesh’s REER has been remarkably stable for the past 20 years (Fig 3). REER trend for the 1970s is characterized by the 40 percent depreciation in 1975-76 and a modest upwards trend⁴ in the remainder of the decade. Except for a period in the mid 1980s, during which the REER appreciated rapidly for three years but was then devalued sharply during 1985, the real effective exchange rate has moved within a fairly small band of about 10% around its trend, which was slow devaluation from 1980 up to about 1997, followed by modest appreciation since then. The strength of the Taka during this period is in part due to the rapid growth of ready-made garment exports, which increased from US\$ 116 million in 1985 to US\$ 4.8 billion in 2000, and increasing remittances, both through formal channels and unrecorded, from Bangladesh workers outside the country. Together, these increases more than offset aid inflows, which declined relative to GDP and were sufficient to balance whatever increases in imports that resulted from the trade liberalization measures implemented during the 1980s and 1990s. However, one consequence of the relatively stable Taka alongside the massive devaluation of the Indian Rupee between 1985 and 1992 was that the bilateral real Taka/Rupee rate appreciated by about 30 percent during the same period (Fig 3). This appreciating trend of the real Taka/Rupee rate continued at a slower pace until 1999.

⁴ IMF statistics on REER do not extend beyond 1980. Hence, earlier RER trends had to be drawn from Rahman, S. (1992), “Structural Adjustment and Macroeconomic Performance” Bangladesh Institute of Development Studies Journal, Volume 20, June – September.



Consequently, the total real appreciation of the Taka relative to its value during the mid-1980s was about 40%. Combined with Bangladesh's gradual removal of QRs and tariff reductions over the same period, this led to a rapid growth of imports from India, which during the 1990s became Bangladesh's largest single supplier, accounting for between 15-18% of its total recorded imports. In addition, studies of informal trade suggest that there has been similar large increase in unrecorded imports from India, with a total value as large as or possibly exceeding the total value of recorded imports. If this is correct, India is supplying about one-third of Bangladesh's total imports. These developments have made the trading relationship with India a key concern in Bangladesh, with some groups using the import competition from India and the bilateral trade deficit to argue against further general trade liberalization, while others are pushing for further trade liberalization combined with reform of the Customs service so as to divert illegal imports into legal channels.

Fig. 2 Real Exchange Rate Indices before 1980



Source: S. H. Rahman (1992)

**Fig 4 Bangladesh- India Real Exchange Rate 1981-2001
(Annual Averages: Increase=devaluation)**

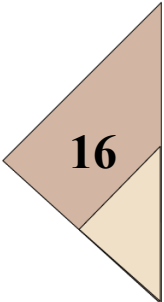
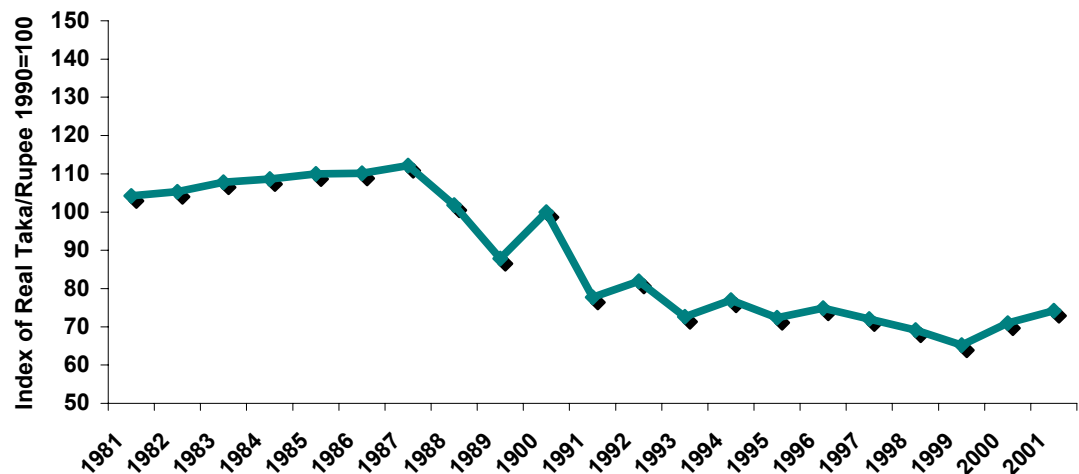
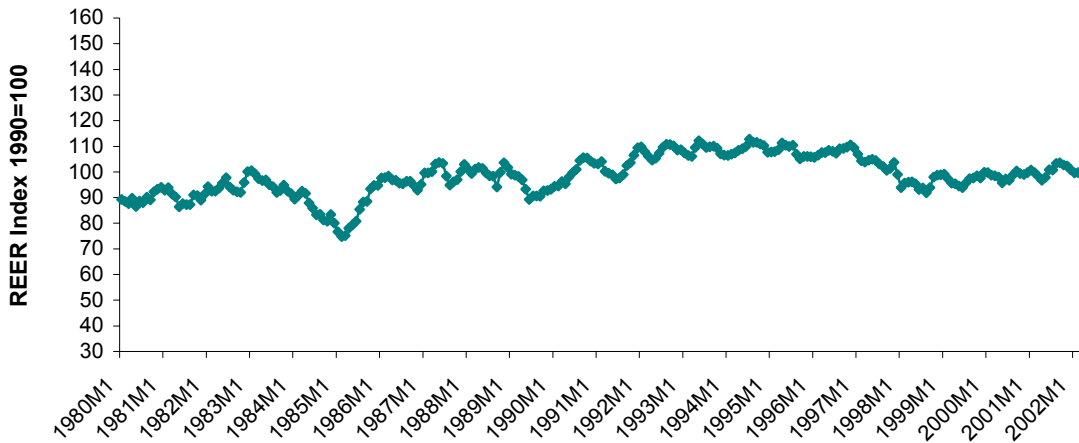


Fig 3 Bangladesh REER 1980-1991
(Monthly: Increase=devaluation)

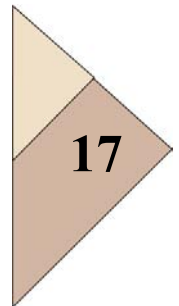


Source: IMF International Financial Statistics, and staff estimates.

II. Other Deregulation

While the main focus of this study is on outward orientation, it is well recognized that trade deregulation alone will not have the full beneficial effects unless supported by other deregulation in the domestic economy (the so called “behind the border” issues). A fuller review of the progress in Bangladesh in this area is available in Ahmed (2002). The summary picture, as reflected in Table 1 above, indicates the following:

- The period of the 1972-75 was characterized by heavy administrative controls on the means of production and pricing. This control was pretty pervasive, including massive nationalization of manufacturing enterprises, banking, public utilities, and distribution of agricultural inputs. State Trade Corporations handled a large chunk of international trade and domestic distribution of commodities. Price controls were pervasive, including manufacturing goods, exchange rate, interest rates, agricultural inputs and outputs, utility rates, and house rents.
- This control-oriented economic management changed quite dramatically starting in 1976, during the second phase. In this phase, the main focus of deregulation was to move towards a market-based economy by removing price controls, initiating de-nationalization and reducing regulatory barriers to private investment. Much of the focus of domestic deregulation was on freeing up agriculture, domestic trade and services. Progress with privatization was limited, even in manufacturing sector. Also, much of the banking and public utilities remained under public management, although the period saw the gradual growth of private sector banking.
- The third phase saw a more rapid pace of deregulation in manufacturing, including more substantive progress with privatization in the manufacturing sector. Private banking also grew significantly, even though the large public banks remained in place. In infrastructure, private telecommunications services (wireless services) emerged while some limited private generation of private power emerged. However, reforms of banking, public utilities, and ports generally lagged behind.



E: Impact of Outward Orientation on Economic Growth and Poverty Reduction in Bangladesh

It is clear from the above that Bangladesh experienced progressive liberalization of its a economy and the trade regime since 1976. Outward orientation gained particular momentum in the 1990s, although important foundations were laid in the 1980s, especially in the garments sector. What has been the impact of this progressive outward orientation on economic growth and poverty reduction?

Average growth and poverty reduction performance over the past 30 years, broken down by the distinct phases of outward orientation are shown in Table 6. The key results are as follows:

- First, trade data confirm the substantial opening up of the economy, progressively over the early years. Thus, the Bangladesh trade-GDP ratio--a standard measure of trade orientation of the economy--rose from an average of 11 percent in 1972-1975, to 17 percent in 1990, and further to 30 percent in 2000. Both imports and exports grew as a share of GDP, with imports growing from an average of 8% of GDP in 1972-75 to 18% in 2000, while exports expanded from 3% of GDP in 1972-75 to 12 % in 2000.
- Per capita GDP growth moved from (-)1.1% during phase one to 1.6% in phase 2, rising to 3.1 % in phase 3.
- Inflation, which is key determinant of poverty, declined from a rapid pace of 47% per annum in the first phase to 9% in the second phase to 6% in the third phase.
- The incidence of poverty (head count index) fell from 88% in 1974 to 59% in 1992 and further declined to 50% in 2000⁵.

Table 6. Growth performance and poverty reduction, 1974-2000

<i>Period</i>	<i>Avg GDP Growth</i>	<i>Avg Per Capita GDP Growth</i>	<i>Average Inflation Rate</i>	<i>Poverty Headcount % end of period</i>	<i>Trade-GDP Ratio End period</i>
1972-1975	2.75	-0.10	47.14	88.14*	11.2♣
1976-1990	3.89	1.58	9.12	58.8**	17.4
1991-2000	4.80	3.09	5.64	49.8***	30.1

*refers to 1973-1974, ** refers to 1991-1992, *** refers to 1999-2000, ♣ average for 1972-75

^b refers 1989-1990. *Source: Bangladesh Bureau of Statistics and staff estimates.*

Although the overall growth and poverty outcomes presented above are the results of a wide variety of economic and social policies, it is fair to conclude that greater outward orientation reflected in trade openness and a supportive macroeconomic management played a key role. Indeed, as argued by Srinivasan and Bhagwati (2002), outward orientation is generally supported by sound macroeconomic management that helps maintain low inflation to preserve the competitiveness of the exchange rate. This is

⁵ There are some problems of comparability of these point poverty estimates over the various years, but there are no doubts about the general trend of these numbers. See Ahmed 2002.

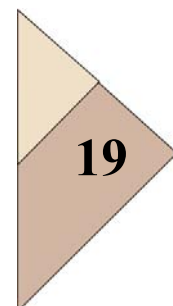
also true of Bangladesh. The rapid control over inflation during phase 2 and 3 was not an isolated development. It was aimed at supporting the management of the external balances and the real exchange rate. As well, progressively improving exchange rate management and supportive prudent macroeconomic management were complemented by other market-oriented reforms such as de-regulation of industries and a liberal investment regime that encouraged investment.

While these aggregative results give comfort that outward orientation has on average yielded positive outcomes in terms of better growth and lower poverty, it would be reassuring to obtain more direct linkage between outward orientation and poverty reduction by looking at sectoral performance: employment and income generation in manufacturing--large and small-scale; in agriculture and non-farm/off-farm activities; and within the broad category of service activities.

For Bangladesh, a labor abundant economy, growth to be pro-poor must also be based on labor-intensive production. Trade openness promotes production in accordance with a nation's comparative advantage, which in Bangladesh's case, would be in those production activities that have a relatively high labor to capital ratio.

Sector Growth Performance: Table 7 provides a summary and comparison of growth performance in key sectors over the three phases.⁶

a): Agriculture. In the first phase, Bangladesh began with a pretty heavy dose of controls over both the product and input markets for agriculture. Following the debacle of the phase 1, agriculture growth picked up considerably in phase 2, fueled by input-output deregulation as well as the supportive policies of the green revolution (the seed-fertilizer technology). Deregulation in agriculture started in early 1980s. This involved liberalization of the fertilizer and irrigation equipment markets, and the reform of the public marketing of food grains. While much of the reform focused on agricultural inputs, on the output side the main noteworthy reform was the abolishment of most forms of food rationing and the monopoly in the import and export of food grain. The overall effect of this deregulation was positive, contributing to an expansion in agricultural productivity and value-added⁷. Much of the positive impact happened in rice production -- the dominant agriculture activity. Deregulation enabled rapid adoption of the high-yielding varieties (HYV) of rice, causing paddy production to increase at a faster pace than population and Bangladesh achieved rice self-sufficiency by the early 1990s.



⁶ Comparison of sectoral performance is a bit complicated by the revision of national accounts in 1999. The revised series do not go far enough and stop at 1980. For this study, we use the old series to calculate growth indicators for phases 1 and 2 and the new series for phase 3. This could bias the magnitude of the growth estimates somewhat but does not affect the direction of change as indicated by the comparison of growth estimates for 1980-90 in the two series.

⁷ Abdullah and Shahabuddin 1997; Ahmed 1997.

Table 7. Sectoral Performance (percent)

Name of Sub-Sector	Average growth Share in 1975		Average growth (1976-90)	Share in 1990		Share in 2000
	(1972-75)	GDP		GDP	Average growth (1990-2000)	
Agriculture & Forestry	1.02	43.09	2.58	25.15	2.60	19.49
Crops & Horticulture	0.98	39.34	2.69	19.34	2.85	14.59
Animal Farming	1.64	3.75	2.10	3.73	2.51	3.02
Fishing	0.36	5.00	2.35	4.37	8.21	6.09
Manufacturing	-10.92	10.88	4.99	12.52	6.90	15.40
Large & Medium Scale	-22.36	4.81	4.94	8.91	6.95	11.01
Small Scale	0.87	6.07	5.15	3.61	6.78	4.39
Construction	-19.44	2.81	6.02	6.01	8.31	7.84
Wholesale & Retail Trade	12.24	8.65	4.50	12.17	5.67	13.35
Hotel & Restaurants	Na	Na	4.12	0.59	5.49	0.63
Transport, Storage & communication	3.66	10.70	4.57	9.32	4.89	9.20
Other services		18.87		29.87		28.0

Source: Statistical Yearbook of Bangladesh 2000; BBS

Direct effects of trade liberalization came in the form of imports of agricultural inputs and machinery in the mid-1980s (coupled with deregulation of domestic fertilizer markets) providing the initial impetus to agricultural growth in the late 1980s, which was then sustained in the 1990s. In agriculture, therefore, trade liberalization with supportive liberalization of the input market, provided impetus to a labor-intensive import substituting sector that expanded, through higher area coverage, intensity of cultivation, and adoption of high-yielding technology. Moreover, there is now a growing segment in agriculture – vegetables and horticulture – that is geared towards export markets. Export volumes for such products, though modest in relative terms (about \$40 million in FY02), has been rising rapidly in the recent past (exports in FY00 were five times those of FY90). A major export-oriented agriculture sector that benefited from trade liberalization is the fishing industry (Box 4 and Table 8). Fishing as an economic activity grew at a record pace during the 1990s, largely driven by the export-oriented shrimps production that responded to exchange liberalization and other trade incentives. Liberalization of imports allowing duty-free inputs most needed in commercial fish farming also helped strong growth .

Yet, the agriculture sector as a whole did not show dynamism. The performance of the agriculture sector remains heavily dependent upon the contribution of rice, which seems to have become constrained by the slowdown in growth of of domestic demand due to low income elasticity and the lower population growth rate. Given the importance of agriculture for poverty reduction, it has been a subject of considerable analysis, debate and discussion. The upshot of the main results of this intensive research is⁸:

⁸ A good summary of these issues is contained in Abdullah and Shahabuddin 1997; Mahmud 1998; and Faruqee 1998.

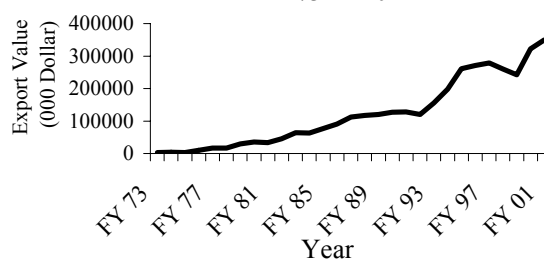
- Despite progress, agriculture continues to suffer from many controls over output pricing, marketing, and input supply; removal of these controls will benefit farm production and value-added.
- Deregulation has focused mostly on input markets; on the demand side, low expansion of the pace of domestic demand and inadequate export orientation continue to limit the incentives for production;
- Diversification of agricultural production away from the heavy reliance on rice is important to raise agricultural value-added; this in turn will require policies to boost domestic demand along with efforts to remove constraints to agricultural exports.

Box 4: Export-oriented Shrimp Sector

The shrimp sector has expanded rapidly over the past three decades, thanks to the rise in the volume of exports. Labor-intensive in character, it now employs over half a million rural poor in various stages of processing and shrimp culture. Shrimp farming is now a major economic activity in the coastal regions of Bangladesh. Bangladesh accounted for 4.1 per cent of global production of commercial shrimp in the mid-1990s and, after RMG, the shrimp sector is now the second largest export industry. The production of shrimps doubled in the last decade, while exports multiplied three times within the same period of time. Its share in fishing sub-sector rose from 11 percent to 14 percent by the end of the decade, but it made up 90 percent of export earnings from fish.

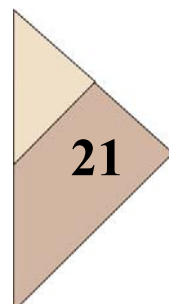
Export-oriented shrimp has expanded from a US\$10 million business in 1975 to US\$77 million in 1985, and is running close to US\$400 million today (Table 8 and Fig. 5). Over the last decade, the industry has registered a robust growth rate of about 9 per cent per annum (in dollar terms). Except for the readymade garments industry, no other industry in Bangladesh has been able to match this performance.

Fig. 5 Export Value of Shrimp
FY 73- FY 01



There are now about 124 shrimp processing factories in Bangladesh mostly in Khulna and Chittagong and around 60 hatcheries mostly in Cox's Bazar. Substantial employment in the shrimp sector has been created (including female income generating opportunities) both in upstream and downstream activities, (e.g., services, transport, catching of shrimp fries, shrimp processing etc.). At an average income of Tk. 3000 per month for a household engaged in some stage of shrimp farming or marketing, this activity pulls a large number of the rural poor out of poverty.

However, environmental degradation posed by this industry is a challenge and a coherent strategy is yet to be put in place. The industry still lacks quality and phyto-sanitary standards on an international scale. More than once in the past, its exports had suffered bans from importing countries and future bans cannot be ruled out, unless the issue of quality standards is taken up seriously. The industry therefore urgently needs a coherent strategy to prepare to respond to emerging trends in the highly competitive global market with efficient and cost effective measures.



- The prospects for non-rice agriculture exports are also limited by the relatively low productivity. So, policies for promoting technological progress in non-rice agriculture are very important.
- Inadequate agricultural infrastructure is another constraint on farm production and productivity.
- Overall water management and flood control policies are deficient, suffering from serious management problems, including O&M.
- Land markets function inefficiently due to inadequate land administration policies, including the inadequacy of the legal process for land tenure arrangements and land sales⁹.
- Finally, the inadequacy of the farm credit market remains a major constraint on farm production.

Table 8: Shrimp production and exports

Year	Production (MT)	Value Added (Million Dollars)	Export of Frozen Shrimp (Million Dollars)	Export of Frozen Shrimp (Quantity in tons)
FY 90	70776	121.85	126.9	17505
FY 91	80384	138.42	128.0	17985
FY 92	98419	164.69	119.7	16730
FY 93	123231	225.73	155.5	19224
FY 94	100542	196.63	197.7	22054
FY 95	113366	244.75	260.7	26277
FY 96	101655	267.24	270.5	25225
FY 97	112634	286.44	279.2	25742
FY 98	146356	368.85	260.4	18630
FY 99	157371	375.41	242.2	20086
FY 00	170788	386.36	322.4	28514

Source: BBS, EPB

b): Manufacturing. Much of the debate on the possible adverse effects of trade liberalization and denationalization/deregulation policies has concentrated on the impact of these policies in manufacturing. For years, the trade regime in Bangladesh was geared to providing high protection to the manufacturing sector, in general, and some so-called thrust industries like textiles, in particular. While ERP in agriculture were either very low or even negative, average ERP in manufacturing was in excess of 100 percent for much of the 1970s and 1980s. Recently, after all the liberalization of the 1990s, Bangladesh Tariff Commission's Review of Relative Protection 2002 found average ERP in a large sample of manufacturing enterprises to be 78 percent. The Review also found that although average nominal protection rates had come down significantly, the sector stubbornly resisted reduction of the effective rates by pressing for and obtaining reduction in tariffs of intermediate inputs as well as the continuation of tariff concessions by end-use for imported capital machinery and many industrial raw materials.

What has been the effect of this trade liberalization on the manufacturing sector? Since much of the impetus to trade liberalization came in the early 1990s, it is possibly most appropriate to compare the performance of the manufacturing sector in phase 2 and phase 3, with the caveat that even phase 2 benefited from significant deregulation and the rapid expansion of the export-oriented garment sector based on establishment of the free

⁹ See World Bank 2000c.

trade zones (see below). On average, the share of manufacturing in GDP rose by almost 3 percent of GDP in the 1990s, from 12.5 percent in the 1980s. This fact, in itself, belies the contention of critiques who argue that trade liberalization of the 1990s resulted in de-industrialization (Zaid Bakht 2001). Nevertheless, it is accepted that tariff reductions and QR removal introduced a substantial degree of import competition in the local manufacturing sector, forcing enterprises to restructure and raise productive efficiency. Many did, such as ceramics, textiles (new spinning capacities), RMG accessories, electrical goods, etc. Those that failed to adjust had to close down and lay off workers [see World Bank (1999), for a detailed assessment of the impact of trade liberalization on the manufacturing sector]. In this category, were a large number of state-owned manufacturing enterprises which ended up becoming sick (unviable), and could only continue operation with regular budgetary subsidy. In this group were a large number of jute and cotton textile mills, apart from paper and chemical products. Private enterprises which were beneficiaries of high protection for long but failed to adjust following liberalization had no other option but to close down. Some metal products, light engineering, and rubber products are in this group. Such outcomes are but predictable and the natural consequences of trade liberalization.

Manufacturing growth averaged 8.2 percent per annum (only 4.3 percent for non-RMG) in the first half of the 1990s during the peak of the liberalizing period, but tapered off to an average of 5.6 percent in the latter half, to end the decade with an average of 6.9 percent growth, compared to 5 percent in the 1980s. These averages mask the fact that it was the RMG enterprises (in the medium and large scale group) that grew by over 20 percent and drove manufacturing growth, while there was stagnation and even decline in some import-substituting industries – a predictable impact of trade liberalization in a manufacturing sector that enjoyed high protection for a prolonged period. Most notable was a sustained average growth of 6.8 percent in the small scale enterprise sector, compared to only 5 percent growth in the previous decade. This is anything but surprising. Small and rural or peri-urban entrepreneurs typically lack access to licenses, permits or exemptions that their larger compatriots extricate from the controlling authorities. Tariffs and QR regime served as constraints to the availability of raw materials and intermediate inputs for small firms. Thus, import liberalization and the abolition of import licensing improved access of small enterprises to capital machinery, raw materials and implements that could now be purchased readily and at low cost. Import liberalization thus acted to eliminate supply constraints in the sector. Moreover, their products being poor substitutes for imports, small-scale enterprises benefited more from the removal of supply constraints than they suffered from increased import competition, unlike their large-scale counterparts (Bakht 2001).

Growth of RMG industry: The phenomenal growth of the readymade garment sector in Bangladesh is a major success story of an export-oriented activity, giving a substantial boost to domestic manufacturing and exports, while creating direct and indirect employment and investment opportunities in backward and forward linked activities. Notwithstanding the fact that this sector's emergence and expansion is the direct outcome of the global Multi Fiber Agreement (MFA) regime, there is no denying that it has had a stellar impact on overall economic growth, income generation and poverty reduction in Bangladesh. Table 9 gives a summary picture of the evolution of this sector from humble beginnings in the late 1970s.

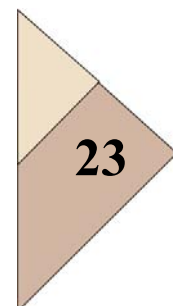


Table 9: Growth of the RMG Sector

YEAR	Export volume '000 doz	Export mill US\$	Share in total exports	Employment mill workers	Number of Garment factories
1985-86	4762.58	131.48	16.05	0.198	594
1990-91	30566.63	866.82	50.47	0.402	834
1995-96	72005.00	2547.13	65.61	1.290	2353
1999-2000	111905.77	4349.41	75.61	1.600	3200
2001-2002	140444.59	4583.75	76.57	1.800	3618

Source: BGMEA

From a miniscule share of about 4 percent in total exports in the early 1980s, garments now constitute 76 percent of total exports from Bangladesh, raking in nearly \$5 billion of foreign exchange, out of total export earnings of \$6.8 billion in 2001-02. Net domestic value addition--hitherto a weak point, on account of the heavy dependence of the sector on imported fabrics, yarn and accessories--has risen substantially, so much so that nearly 60 percent of the required inputs are now domestically sourced (Table 10), as compared to a mere 36 percent in 1991-92.

This sector has been unique in its ability to create jobs, particularly for the women workforce. From 200,000 workers in FY85-86, RMG industry now directly employs 1.8 million worker--almost 90 percent of them women--in its 3600 factories. This was the fastest employment creation experienced by any sub sector in Bangladesh. The BGMEA, the industry association, claims (perhaps rightly since no serious data has been compiled on indirect employment effects) that a similar number of workers might be employed in a host of support activities (backward and forward linkages, e.g. courier, packaging) that have also emerged alongside the expansion of RMG. The largely female workforce of RMG industries are drawn from the vast reserves of unskilled labor amongst the poor rural communities. Surely, this has made an enormous contribution to lifting several million rural families out of poverty over two decades, quite apart from advancing the cause of women's empowerment in a big way.

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Table 10. VALUE ADDITION IN THE RMG INDUSTRIES (FY 92-FY 02)

(In million US \$)											
	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
Exports of:											-
Readymade garments	1061.9	1231.3	1291.7	1835.1	1984.8	2238	2843.3	2984.8	3082.6	3363.9	3124.6
Knitwear	118.5	204.5	264.14	393.26	598.32	763.3	940.31	1035.4	1269.8	1496.2	1459.2
Specialized textile & household linen	18.431	29.008	31.833	32.883	41.265	51.958	58.205	76.32	96.09	116.58	
Total	1199	1465	1588	2261	2624	3053	3842	4097	4448	4977	4584
Imports against Back to Back L/cs (Textile fabrics and accessories)	745.96	878.06	1033.6	1524.2	1433.6	1580.6	1885.8	1728.6	1992	2141.8	1926.7
Domestic content	452.9	586.8	516.3	704.2	1191	1473	1956	2368	2456	2835	2657
Percentage	37.78%	40.06%	34.89%	32.60%	45.38%	48.23%	50.92%	57.80%	55.22%	56.96%	57.97%

Sources of data: (i) Export Promotion Bureau for Exports; (ii) Bangladesh Bank for Imports

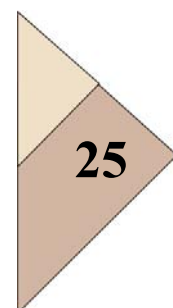
Leather and Leather goods. Another success story in the export industry is the case of leather manufacturing. From a modest level of only \$16 million in 1973, exports of leather and leather goods rose to nearly \$140 million by 1989, and to \$250 million in FY02, making it the fourth largest export item in Bangladesh. Although export growth has been robust, this sector is miles behind its competitors, Pakistan and India, in terms of quality and productivity. While goat hides are reputed to be the best in the world, cow hides are the worst in quality, and the sector has been unable to attract the technology and investment required to raise quality standards to become a significant player in the world market for leather or footwear. Nevertheless, it accounts for 12000 jobs directly and employment has been remarkably stable. Because of the polluting nature of this industry, there are indications that this is a sunset industry in Korea and Taiwan, needing re-locations to such places as Bangladesh; but the investment climate here has not been judged as favorable by prospective foreign investors in the sector.

c): Construction and Other Services. The construction sector benefited in both phases 2 and 3 from the growth of income and from remittance inflows. Investment in housing provided the impetus in the second phase fueled by the rapid growth of remittances, while other construction activities provided the lead in the third phase. Additionally, on the supply side, liberalization of the import regime, and complementary policies of market orientation and de-regulation of the investment regime helped the sector to expand. A liberalized import regime that improved the availability of machinery and construction materials at internationally competitive prices supported the growth of this sector by reducing cost. At the close of the 1990s decade, the share of construction in GDP had risen by nearly 2 percent of GDP, spurred by a significantly higher annual rate of growth (8.3 percent compared to 6 percent in the 1980s).

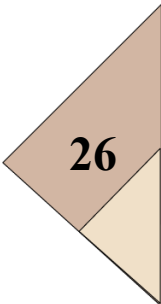
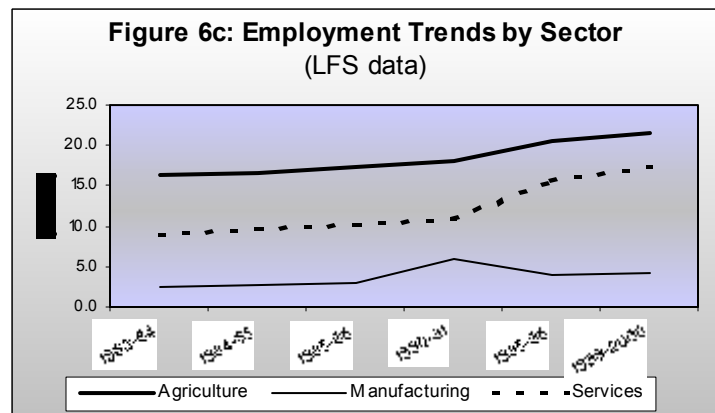
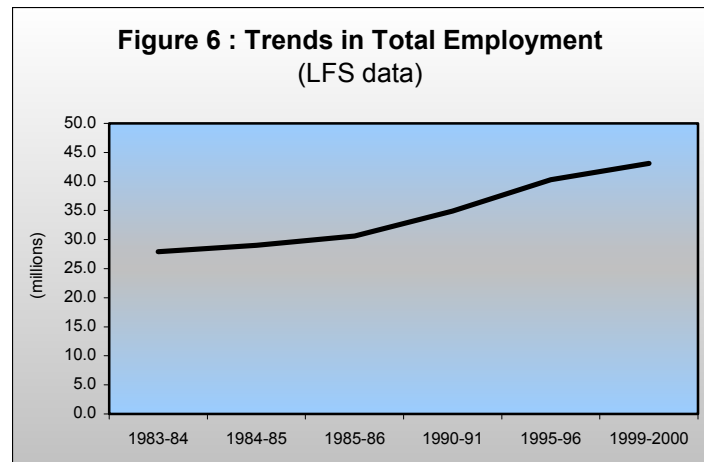
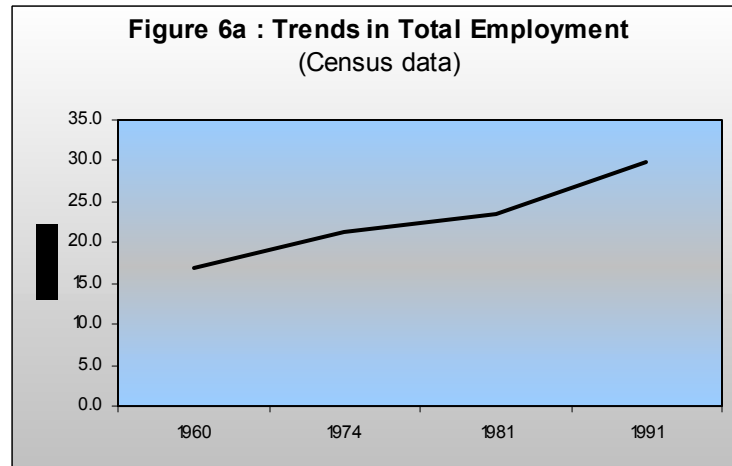
Besides construction, the largest expansion of activity in the 1990s decade came in retail and wholesale trade (average growth up by +2% in 1990s), hotels and restaurants (up by 1.2%) and transport and communications (up 0.3%) – activities that are clearly linked to the level and growth of trade (trade-GDP ratio). The stimulus to these activities of course comes from the spurt in production and investment that may occur in agriculture and industry. Export-oriented manufacturing was the main driver of this growth, followed by re-adjusted import-substituting industries (ISIs), which had to be financially and managerially nimble to remain competitive. Import liberalization facilitated not only export-oriented firms but also the vast majority of small and large firms feeding the domestic market. Some 75-80 percent of Bangladesh's imports continue to be made up of intermediate inputs, industrial raw materials and capital goods. Aggregate production in Bangladesh is still import-intensive. Import liberalization, by removing various control mechanisms, had the general effect of eliminating supply constraints and generating a supply response that contributed to higher GDP growth.

Impact of Trade Liberalization on Employment: Long term employment trend based on Census and labor force survey (LFS) data is shown in Figures 6a-c. These data have to be interpreted with caution as Census and LFS data are not comparable. Also, LFS data since 1989 have been affected by a change in the definition employment. Thus, there are two series: one showing conventional definition and the second showing a modified definition¹⁰. First, the Census data (graph 6a) shows a modest growth (2.0 %

¹⁰ The usual definition refers to persons of age 10 years and above who are employed during the reference period of the survey. Persons working less than 15 hours a week without pay or profit during the reference period in the family farm/enterprise are not considered as employed. In the



p.a.) in total employment between 1974-1991 (unfortunately, data for 2000 has not yet been released). There was a relatively slow expansion between 1974-81 (only 1.4 % p.a.), followed by a more impressive growth between 1981-91 (2.4% p.a.). On the other



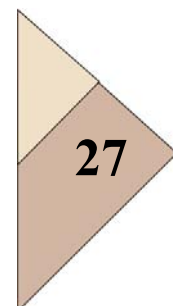
modified definition, persons working in family farm/enterprises without pay are also included. See, Bangladesh Bureau of Statistics (1995)

hand, LFS data (graph 6b) suggest a significantly better employment performance between 1984-2000, expanding at 2.8% p.a. Employment expansion was more rapid in the 1983/84-1990/91 period (3.2 % p.a.) as compared with 1990/91-1999/2000.

What explains this employment pattern, especially the slower pace of employment growth in the 1990/91-1999/2000 period even though GDP growth was faster in the 1990s? To understand this, we need to look into the sectoral pattern underlying these numbers. As shown in Figure 6c, according to the reported LFS data, for the entire period (1983/84-1999/2000) services and manufacturing employment expanded much more rapidly than agriculture, which pulled the overall employment growth. This pattern looks plausible and consistent with the observed growth pattern. But surprisingly, manufacturing employment is reported to have declined significantly between 1990/91 and 1999/2000, following rapid pace of expansion in the 1983/84-1990/91 period. However, services employment expanded more rapidly in the 1990/91-1999/2000 period. This massive decline in manufacturing employment recorded in the LFS is the reason for the observed slower pace of expansion of overall employment in the 1990s. This observation has underpinned the critics' view that trade liberalization has contributed to de-industrialization in Bangladesh.

This is a serious criticism of trade liberalization and deserves close examination. We had earlier noted (Table 7) that manufacturing GDP growth rate showed robust growth in the 1990s, significantly faster than in the 1980s. This growth was fairly broad based, with strong contribution of small and medium enterprises. In particular, we noted the emergence of such dynamic sub-sectors as the export-oriented garment industry along with supportive roles from other export-oriented enterprises as leather and shrimp. How does one reconcile these output growth patterns with the reported employment pattern? A careful look at the LFS data shows a major break from the trend in reported manufacturing employment in 1990/91. There are two important points to note: First, as compared with manufacturing employment of 3.0 million in 1985/86, the number surged to 5.9 million in 1990/91. This is a growth rate of a nearly 20% p.a. as compared with long-term trend of 3.3 % p.a. Second, the reported manufacturing employment collapsed to only 4.0 million in 1995/96--a reduction by 1.9 million jobs in 4 years even while manufacturing output was expanding rapidly by some 6% per annum.

How plausible is this pattern? Clearly in terms of its implications for the standard relationship between output and employment growth, this is highly implausible (see Table 11). So, we need to probe a bit deeper into this. Total employment in large scale manufacturing is only 2 million, of which some 1 million is in the public sector. Generally, it is well known that public manufacturing has excessive staff and has typically experienced low growth and profitability. While protection policies in trade and other interventions prevented a major downsizing in the 1980s, there is no reason to believe any significant expansion in employment here. So, if the reported employment growth did happen in the mid-1980s, this must have happened in private sector manufacturing. It is reasonable to expect some growth in private manufacturing employment in the 1980s as this period saw the emergence of the garment industry and other private investment responding to better incentives from de-nationalization, improved macroeconomic environment and the establishment of the free trade zones. However, there is no basis to support a massive growth in manufacturing employment as reported in the 1990/91 LFS. On the downside after 1990/91, it is true that trade liberalization led to the predictable demise of many state-owned as well those private



enterprises that were unable to adjust and cope with increased competition with imports. But a large number of them that came to be described as “sick” industries were actually unviable to begin with, either due to management problems or an initial debt-equity ratio that was unsustainable. But this reduction was accompanied by rapid growth in employment in the garments industries. As well, the surge in the rate of growth of output in the small enterprises (7.0% p.a. in the 1990s as compared with 5% in the 1980s) must also have contributed to employment growth.

Table 11: Employment Elasticity in Manufacturing

Reference Period	Output growth (% p.a)	Employment growth (% p.a.)	Employment elasticity
1985/86-1990/91	5.0	13.3	2.7
1990/91-1999-2000	6.9	-3.3	Negative

Employment in RMG:

During the 1990s, the fastest rate of employment creation was in the export-oriented RMG sector (Fig. 7) which directly employed 1.5 million workers in 2000 (and 1.8 million in 2002) growing from only 200 thousands in 1990/91, 80 percent of whom were females. It is important to note that the RMG sector helped create jobs in complementary industries or services, such as accessories, packaging, toiletries (demanded by newly employed female RMG workers), courier, finance, transport and telecommunications services, etc. BGMEA claims, quite rightly, that the RMG sector creates as many jobs in these complementary enterprises as there are in RMG units themselves. That means, nearly 3 million workers directly or indirectly depend for their employment on the existence and expansion of the RMG sector. Although RMG operates in a free trade enclave environment, its growth is clearly based on Bangladesh’s comparative advantage in a labor- and non-skill intensive activity – one that has been sustained by trade and exchange liberalization in addition to the quota regime offered under the MFA. Given this, it is plausible to believe that the job losses suffered in the import-substituting group of industries is likely to have been more than compensated by the rapid job creation in the RMG industry as well as in those manufacturing and service activities that were linked to RMG. Importantly, RMG wages were well above the poverty equivalent wages as shown in Fig. 8, implying that workers

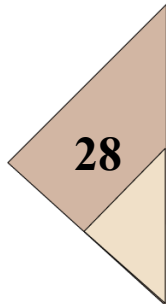


Fig. 7 RMG Employment FY 82-FY 00

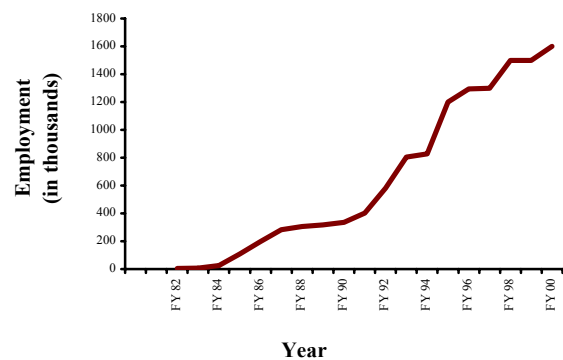
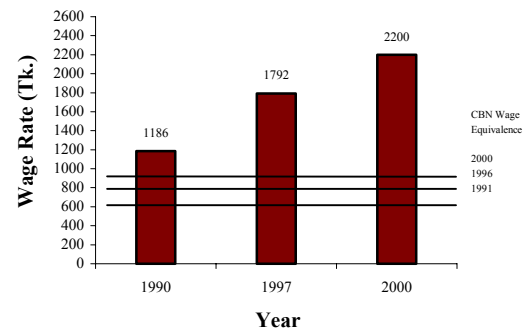


Fig. 8 : Average Wage of RMG Workers 1990, 1997, 2000



in this industry who generally came from poor rural families were able to pull nearly two million households, that is 13 percent of the poor households, out of poverty.

These positive developments notwithstanding, the phase out of the MFA in January 2005 does raise a host of questions regarding the sustained impact of this sector on employment and real wages. A valid question that might be raised at this juncture is whether or not Bangladesh's preferential access to the US (under MFA quota) and EU (facilitated by GSP) markets, complemented by trade and exchange liberalization at home, has helped create durable comparative advantage in RMG exports. In other words, was the phenomenal expansion of RMG exports in the 1990s¹¹ largely driven by the MFA preferential access in North American markets (51% of Bangladesh RMG exports) and GSP concessions in EU (destination of 46% of RMG exports)? As an LDC, Bangladesh will continue to enjoy GSP concessions until 2010, although more competition is likely from countries unshackled from the MFA quota after 2005.

There is no denying that the MFA provided the basis for as well as the stimulus to the RMG sector. Nevertheless, on the whole, Bangladesh's position as a low-cost supplier of RMG (in basics, and standards, rather than high-value items) is now well established (See Annex C for details). This is its strength, going forward. Yet, transforming comparative advantage based on low labor-cost into competitive advantage in a post-MFA world requires other steps beyond trade and exchange liberalization. According to market experts, Bangladesh RMG sector fares relatively poorly in terms of quality, delivery lead times, and market orientation. These are challenges that the sector has to face in the highly competitive post-MFA environment. Of late, there are signs that it is gearing up to meet these challenges head on¹². To conclude, there are challenges and opportunities for Bangladesh RMG sector in the post-MFA world. For one, the RMG export market is expected to expand from the current \$195 billion to \$350 billion in 2005-7, and even larger thereafter. The challenge for Bangladesh is to maintain, if not expand, its present share of 2.6 percent of this expanding market.

Employment in Off-Farm Activities: According to a recent study by Hossain et al (2002), the importance of agriculture as a source of employment for rural workforce has declined over time. By 1999-00, barely 14 percent of rural land-poor households depended on agriculture for their employment, falling from 31% in 1987/88 (Fig. 9). Most were engaged in rural off-farm and non-farm activities. The dominant off-farm and non-farm activities were, however, construction, trade and business, transportation and professional services. In 1999/00, as many as 77 percent of rural households were engaged in such activities (Hossain et al, 2002). Earnings from non-farm activities were also much greater--often nearly three times that of farm employment (Fig. 10).

¹¹ Average annual growth of RMG exports in the 1990s was 17%, with one-third of these exports (knitwear) registering a phenomenal 27% growth, and the remaining two-thirds (woven garments) growing at 12% per annum.

¹² A study by the Swiss firm, Gherzi Textil, has been completed, under the Ministry of Commerce, which lays down the options for the Bangladesh RMG sector for facing the challenges of greater competition after the phase out of MFA in 2005.

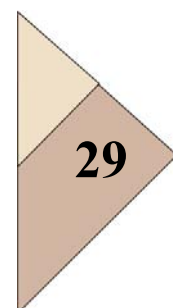


Fig. 9: Structure of Farm and Off-farm Employment

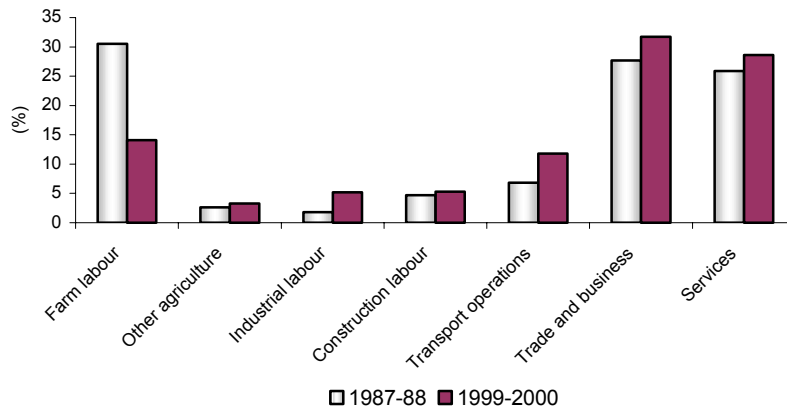
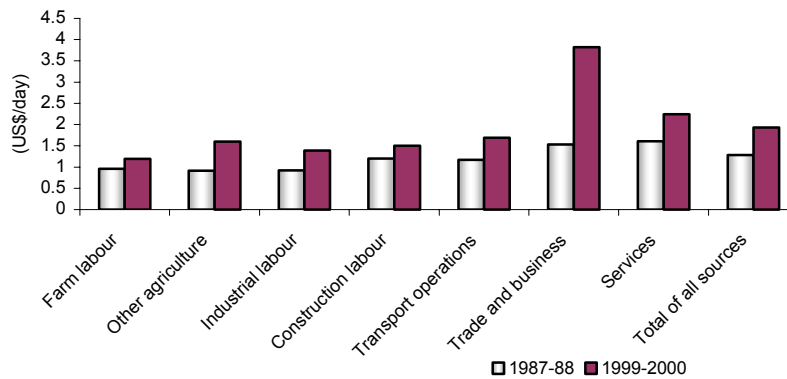


Fig. 10 : Earnings from Farm and Off-farm Employment

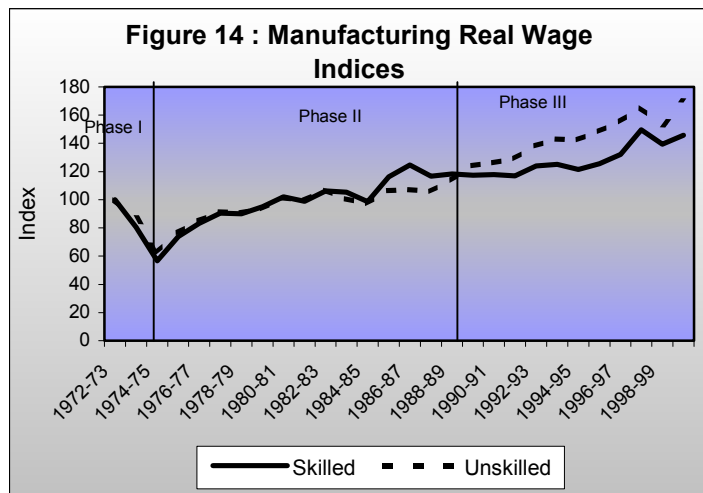
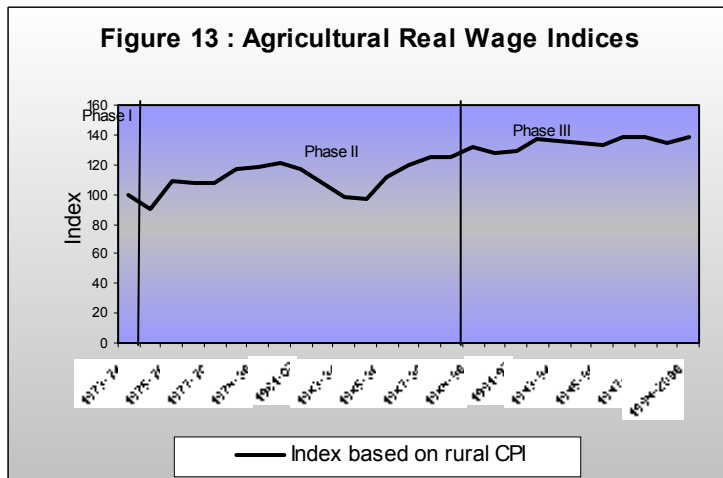


Importantly, the study shows that the employment share of rural manufacturing grew from 1.8 % in 1987/88 to 5.2 % in 1999/2000. This result also casts substantial doubt to the LFS reported data about a massive decline in manufacturing employment between 1990/91 and 1999/2000. Overall, the plausible conclusion is that the manufacturing employment number reported in the LFS 1990/91 is incorrect. Excluding this data, the manufacturing employment in the 1990s is likely to have grown significantly, although less rapidly than in the 1980s due to short-term adjustment effects of trade and other liberalization policies on contracting inefficient industries, especially in the public sector.

Trends in Real Wages: The trend in real wages for unskilled workers in three sectors--manufacturing, agriculture and construction--is shown in graphs 11-13 below. By and large, real wage trends in manufacturing confirm the prediction of theory that trade openness pushes up the price of the abundant factor—unskilled labor, in the case of Bangladesh. On average, real wages of unskilled workers in manufacturing grew by 2.4 percent since FY1973, which is faster than per capita GDP, and, importantly, faster than real wages of skilled labor during the third phase of rapid trade liberalization. Agricultural wages show much more volatility, being affected by floods and other natural disaster and, on average, show a modest increase in real wages (only 1.5% per annum). The slower growth of real agricultural wages is, in part, due to low average long-term

growth in the sector--only 2.2% per annum, which is barely at par with population growth and substantially below the growth in the rest of the economy.

Putting together the output, employment and wage picture, it seems that the Lewis (1950) model of unlimited supply of labor fits well with the Bangladesh agricultural scene. Faced with low average productivity and massive underemployment, the pace of labor absorption in agriculture is contracting, simply because agriculture is unable to create enough jobs to absorb the growing rural population..



Non-agricultural employment and output expansion is moving much more rapidly, but without driving up the marginal productivity and real wages growth noticeably in agriculture yet. So, the “turning point” whereby real wages in agriculture is driven up by the contracting labor availability in agriculture is yet to come¹³. As we noted earlier, there are a host of factors that constrain agriculture sector performance and the sector has experienced only limited trade liberalization (fisheries). The pull factor from trade liberalization in manufacturing has not worked very much because the key raw material (cotton) feeding the dynamic manufacturing activity (garments) is wholly imported. On the other hand, the primary raw material (jute) that has historically fed into manufacturing, is gradually being phased away because of the dying jute industry due to changing world demand.

Unskilled construction workers have on average also gained a 2.4% per annum increase in real wages. Much of this increase came during the second phase, while real wages stagnated in the third phase. This surprising result is explained by two factors: First, much of the growth in construction has been driven by rapidly growing demand during the mid-1970s to the late 1980s fueled by remittances from the Middle East. This expansion of remittance income slowed down in the 1990-2000 period. Second, excess supply of urban housing has resulted in significant drop in housing prices reducing demand for unskilled construction workers.

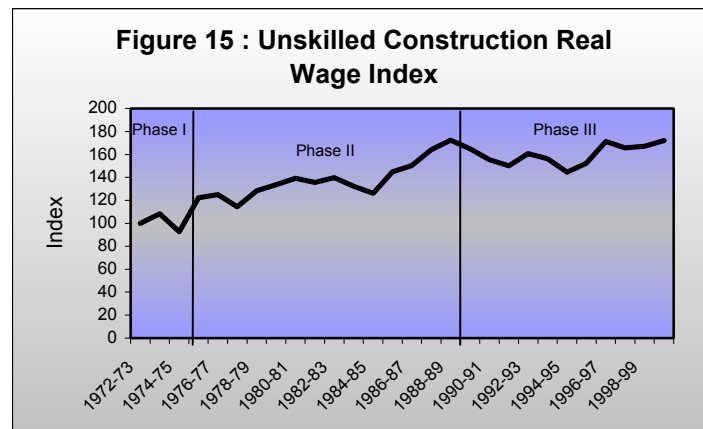
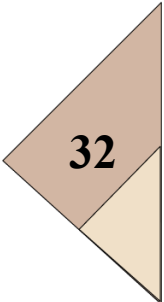


Table 12 : Sectoral Growth of Real Wages for the Poor (% p.a)

<i>Reform Phase</i>	<i>Unskilled Manufacturing</i>	<i>Agriculture</i>	<i>Unskilled construction workers</i>
1972-75	-20.7	-10.3	-3.1
1976-90	4.9	2.9	4.4
1990-2000	3.8	0.5	0.2
1972-2000	2.4	1.5	2.4

Overall, it is fair to conclude that deregulation and trade liberalization has been favorable for supporting a modest increase in real wages of unskilled workers throughout

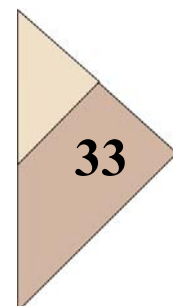
¹³The authors benefited from discussions with Professor Wahiduddin Mahmud who agreed that a tightening of the wage labor market is yet to occur in Bangladesh agriculture.

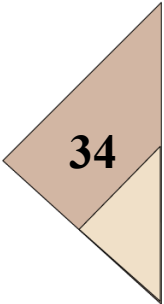
the economy. Unskilled labor in manufacturing has gained most, benefiting from the rapid expansion of such dynamic export industries as garments. The benefit was constrained in agriculture due to weaker progress in deregulation, export promotion and other supportive policies. Also, the pull factor in agriculture from manufacturing has been modest (only in fisheries) due to weak forward linkages between agriculture and manufacturing. Indeed stronger focus on export markets for agro-processing enterprises (as in fisheries) will likely support a more rapid growth in agricultural incomes and real wages. In construction, rapid growth in income from the export of labor to the Middle East and other countries supported the construction boom in the mid-1970s to the late 1980s, thereby contributing to the growth of real wages. Domestic slowdown in the housing market along with slower pace of expansion in remittance income has constrained the growth of real wages in construction in the 1990s.

F: Conclusions

In this paper we have provided broad evidence that trade liberalization and economic deregulation in Bangladesh have contributed to growth of output and helped reduce poverty. This policy of deregulation and trade liberalization started in 1976, but gained momentum in the early 1990s. While the positive effects on output expansion was considerably larger in the 1990s, corresponding broadly with a much faster pace of trade liberalization, the associated poverty reduction impact was higher in the 1976-90 phase of deregulation. This was because employment and real wage growth was slower in the 1990s as compared with 1976-90. Among the reasons for this outcome is the lack of dynamism in agriculture due to slower reforms; a slowdown in the housing market due to excess supply, thereby constraining the growth of real wages of unskilled construction workers; and adjustment in the manufacturing sector, wherein inefficient protected industries contracted reducing employment growth.

This might be tempting for critics to conclude that trade liberalization is not good for poverty reduction. This is a wrong conclusion for a number of reasons. First, overall output expansion has been much more rapid in the 1990s, contributing positively to poverty reduction. Second, the increase in income inequality that has reduced the poverty impact of growth, as has been observed in other deregulating economies like China and India, is simply an indication that public policy needs to be more sensitive to pushing for pro-poor growth by supporting investments in agriculture and rural non-farm activities. Indeed, with better agricultural policies, including public investments in rural infrastructure, and policies for promoting rural non-farm enterprises, growth can be made more pro-poor. Third, so far as the direct effects of trade liberalization are concerned, these have been generally positive. Notwithstanding the contraction of inefficient protected industries, overall manufacturing output grew much more rapidly in the 1990s than in earlier periods. Also, manufacturing employment and wages of unskilled workers grew significantly. So, the fear of “de-industrialization” due to trade liberalization is unfounded. As long as resources could move with ease to labour-intensive industries which could be competitive internationally, the de-industrialization phase of any trade liberalization would be short-lived. The important thing is to remove constraints on resource movement rather than worry about de-industrialization as being inevitable. Indeed, the rapid expansion of the labor-intensive, export-oriented garments sector is a clear indication that an environment in which investors face international prices of inputs and outputs can be a rapid source of employment and income creation for the poor. Such a claim would be difficult to make for an inward-oriented trade regime. This calls for a faster pace of trade liberalization rather than trade protection.





Annex A.

TableA.1 Growth of the RMG Sector*

YEAR	Export volume '000 doz	Export mill US\$	Share in total exports	Employment mill workers	Number of Garment factories
1983-84	1143.55	31.57	3.89	...	134
1984-85	4209.09	116.20	12.44	...	384
1985-86	4762.58	131.48	16.05	0.198	594
1986-87	10818.68	298.67	27.74	0.283	629
1987-88	15717.81	433.92	35.24	0.306	685
1988-89	17064.21	471.09	36.47	0.317	725
1989-90	22608.84	624.16	32.45	0.335	759
1990-91	30566.63	866.82	50.47	0.402	834
1991-92	42836.02	1182.57	59.31	0.582	1163
1992-93	46717.44	1445.02	60.64	0.804	1537
1993-94	45166.00	1555.79	61.40	0.827	1839
1994-95	62512.00	2228.35	64.17	1.200	2182
1995-96	72005.00	2547.13	65.61	1.290	2353
1996-97	80986.40	3001.25	67.93	1.300	2503
1997-98	98194.37	3781.94	73.28	1.500	2726
1998-99	101449.95	4019.98	75.67	1.500	2963
1999-2000	111905.77	4349.41	75.61	1.600	3200
2000-2001	124017.05	4859.83	75.14	1.800	3480
2001-2002	140444.59	4583.75	76.57	1.800	3618

(*) Reliable data is only available since early 1980s.

Source: Export Promotion Bureau and BGMEA.

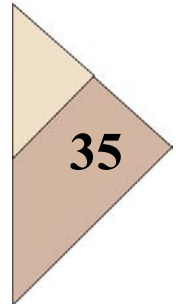


Table B.1 : Nominal and Real Wage Indices by Major Sectors

Year	Nominal Wage Index				Rural Consumer Price Index ^b	Cost of Living Index of Industrial Workers ^c	Cost of Living Index of Industrial Workers	Real Wage Index						
	Agriculture	Manufacture		Construction				Agriculture ^d	Agriculture ^e	Manufacture		Construction		
		Skilled	Unskilled							Skilled	Unskilled			
1972-73		100	100	100	100	100	100	100	100	100	100	100	100	100
1973-74	100	112	121	151	100	100	139	100	100	80	87	100	87	108
1974-75	140	126	139	207	156	161	223	90	87	57	62	87	57	93
1975-76	150	140	145	231	137	136	189	109	96	74	77	109	74	122
1976-77	144	152	156	229	134	132	183	108	93	83	85	108	83	125
1977-78	168	196	198	248	155	156	217	108	100	90	91	108	90	114
1978-79	199	213	215	304	171	171	237	116	109	90	91	116	90	128
1979-80	238	259	256	365	201	196	273	118	101	95	94	118	95	134
1980-81	259	300	298	410	215	212	294	121	108	102	101	121	102	139
1981-82	305	336	339	462	260	245	340	117	100	99	100	117	99	136
1982-83	300	376	378	495	279	255	354	108	90	106	107	108	106	140
1983-84	308	415	396	521	313	284	394	98	81	105	101	98	105	132
1984-85	345	438	432	560	355	319	444	97	82	99	97	97	99	126
1985-86	412	568	519	707	370	351	488	111	90	116	106	111	116	145
1986-87	506	685	590	828	423	395	550	120	94	125	107	120	125	150
1987-88	564	683	620	961	453	421	585	124	98	117	106	124	117	164
1988-89	599	741	714	1079	479	450	626	125	98	118	114	125	118	172
1989-90	669	792	837	1111	509	485	674	132	103	118	124	132	118	165
1990-91	710	847	906	1115	557	517	718	128	100	118	126	128	118	155
1991-92	766	877	969	1126	592	540	750	129	102	117	129	129	117	150
1992-93	819	931	1039	1206	597	540	751	137	108	124	138	137	124	161
1993-94	856	977	1117	1218	620	561	780	136	107	125	143	136	125	156
1994-95	889	1014	1190	1206	673	600	834	135	106	122	143	135	122	145
1995-96	934	1089	1286	1322	701	624	867	133	105	126	148	133	126	152
1996-97	970	1139	1341	1477	697	620	862	139	109	132	156	139	132	171
1997-98	1005	1356	1498	1501	728	652	906	138	109	150	165	138	150	166
1998-99	1048	1388	1525	1663	780	716	995	135	106	140	153	135	140	167
1999-2000	1095	1490	1734	1758	793	735	1022	138	108	146	170	138	146	172

a/ Base year for agriculture is 1973-74

b/ Rural Consumer Price Index constructed from S.R. Osmani up to 1986-87. The following years have been calculated by taking the average of "Consumer Price Index for Families at Dhaka, Chittagong, Khulna and Rajshahi" (from Statistical Yearbook, BBS) and calculating the growth rate. This growth rate is then applied to Osmani's data in order to get the Rural CPI from 1987-88 to 1999-2000.

c/ Base year: 1973-74

d/ Based on Rural CPI

e/ Based on COL (Bangladesh Economic Review 2001, pg.160)

Sources:

1. Bangladesh Economic Review 2001 (pg. 160), BBS
2. Statistical Yearbook of Bangladesh 1990, 1995 & 2000

Table B.3 : Employment Trends				
(in millions)				
Census				
	1960	1974	1981	1991
Agriculture	14.2	16.8	14.5	16.2
Manufacturing	0.8	1.0	1.0	1.0
Services	1.8	3.6	8.1	12.6
Total	16.8	21.4	23.6	29.8
Source: Bangladesh Population Census 1974, 1981, 1991, 2001				

Table B.4 : Employment Trends						
(in millions)						
Labour Force Survey						
	1983-84	1984-85	1985-86	1990-91	1995-96	1999-2000
Agriculture	16.4	16.7	17.4	18.0	20.6	21.6
Manufacturing	2.5	2.7	3.0	5.9	4.0	4.2
Services	9.0	9.6	10.2	11.0	15.7	17.3
Total	27.9	29.0	30.6	34.9	40.3	43.1
Source: Labour Force Survey, December 1966, 1995, 1996, 2002						



Value and Prices of readymade garments Imported into UK
(Hong Kong labor costs typically 3.5 to 4 times Bangladesh)

Table C.1: Men's Woven Cotton Shirts; 1995 and 2000

Supply countries	1995				2000			
	Volume pcs mn	% share	Value £million	Unit £/pc	Volume pcs mn	% share	Value £million	Unit £/pc
All	73.24	100	290.587	3.97	46.529	100	248.142	6.60
Intra EU	9.872	13.4	61.63	6.24	5.608	12.1	61.856	25.5
Extra EU	63.367	86.6	228.956	3.61	40.921	87.9	186.286	4.50
Mauritius	1.530	2.1	10.017	6.55	2.739	5.9	16.906	6.20
India	14.541	19.9	49.126	3.38	5.688	12.2	17.273	3.02
Bangladesh	15.020	20.5	30.026	2.00	5.135	11	12.460	2.43
Indonesia	-	-	-	-	5.245	11.3	22.655	4.32
Hong Kong	15.166	20.7	74.584	4.92	10.225	22.1	54.254	5.30
Others	26.952	36.8	126.834	4.71	17.402	37.5	62.738	3.61

Source: UK National Statistics

Table C.2: Men's Woven Shirts other than Cotton; 1995 and 2000

Supply countries	1995				2000			
	Volume pcs mn	% share	Value £million	Unit £/pc	Volume pcs mn	% share	Value £million	Unit £/pc
All	64.146	100	145.817	2.26	61.184	100	184.728	3.02
Intra EU	3.837	6	19.202	5.00	3.122	5.1	22.220	7.12
Extra EU	60.309	94	126.616	2.10	58.061	94.9	162.508	2.80
India	-	-	-	-	3.921	6.4	11.274	2.88
Bangladesh	33.310	51.9	50.826	1.53	24.719	40.4	42.577	1.72
Indonesia	-	-	-	-	5.537	9	18.837	3.40
Hong Kong	9.803	15.3	30.633	3.12	11.575	18.9	46.387	4.00
China	6.642	10.4	13.354	2.01	-	-	-	-
Others	14.661	22.9	51.004	3.48	15.432	25.2	65.653	4.25

Source: UK National Statistics

Table C.3: Men's Knitted Cotton Shirts; 1995 and 2000

Supply source	1995				2000			
	Volume pcs mn	% share	Value £million	Unit £/pc	Volume pcs mn	% share	Value £million	Unit £/pc
All	28.269	100	102.71	3.63	41.533	100	146.127	3.52
Intra EU	3.626	12.8	19.66	5.42	4.245	10.2	32.443	7.64
Extra EU	24.643	87.2	83.05	3.37	37.288	89.8	113.684	3.05
Bangladesh	-	-	-	-	8.285	19.9	15.013	1.81
Turkey	2.237	3.5	9.568	4.28	3.732	9	12.505	3.35
Mauritius	1.543	5.5	5.429	3.52	2.861	6.9	8.826	3.08
India	2.254	8	5.348	2.37	-	-	-	-
Sri Lanka	2.507	8.9	6.866	2.74	2.313	5.6	8.042	3.48
Hong Kong	5.61	19.8	25.677	4.58	5.03	12.1	21.896	4.35
China	-	-	-	-	1.952	4.7	8.184	4.19
Others	10.491	37.1	30.162	2.88	17.36	41.8	71.661	4.13

Source: UK National Statistics

Table C.4: Men's Woven Cotton Trousers; 1995 and 2000

Supply source	1995				2000			
	Volume pcs mn	% share	Value £million	Unit \$/pc	Volume pcs mn	% share	Value £million	Unit £/pc
All	71.62	100	364.14	5.08	110.21	100	657.97	5.97
Intra EU	23.635	33	114.53	4.85	17.529	16	195.5	11.15
Extra EU	47.984	67	249.61	5.20	92.68	84	462.45	4.99
Turkey					4.693	4.3	29.856	6.36
Morocco	6.851	9.6	31.807	4.64	14.317	13	75.584	5.28
Mauritius	2.118	3	11.855	5.60	5.031	4.6	25.018	4.97
Pakistan	0.095	0.1	8.914	-	6.348	5.8	19.47	3.07
Bangladesh	-	-	-	-	8.910	8.1	28.808	4.54
Sri Lanka	-	-	-	-	4.855	4.4	23.708	4.88
Indonesia	-	-	-	-	2.118	1.9	11.461	5.41
China	-	-	-	-	2.812	2.5	11.661	3.95
Hong Kong	15.826	22.1	75.181	4.75	14.774	13.4	75.977	5.14
Israel	1.243	1.7	29.33	-		-	-	-
Others	45.487	64.5	207.05	4.55	46.352	41.9	356.427	7.69

Source: UK National Statistics

Table C.5: Women's Woven Cotton Trousers 1995 and 2000

Supply country	1995				2000			
	Volume pcs mn	% share	Value £million	Unit £/pc	Volume pcs mn	% share	Value £million	Unit £/pc
All	45.586	100	202.593	4.44	130.026	100	684.878	5.27
Intra EU	11.405	25	70.337	6.17	15.586	12	160.629	10.31
Extra EU	34.181	75	132.216	3.87	114.968	88	524.429	4.56
Turkey	2.065	4.5	8.846	4.28	17.275	13.3	76.788	4.45
Romania	-	-	-	-	13.675	10.5	49.074	3.59
Morocco	2.768	6.1	15.866	5.73	11.99	9.2	58.521	4.88
India	3.779	8.3	9.652	2.55	5.381	4.1	15.252	2.83
Bangladesh	-	-	-	-	4.479	3.4	14.612	3.26
Sri Lanka	-	-	-	-	5.137	4	20.333	3.96
Indonesia	-	-	-	-	2.464	1.9	12.907	5.24
China	4.356	9.6	9.594	2.20	5.486	4.2	20.411	3.72
Hong Kong	10.552	23.1	44.119	4.18	21.892	16.8	134.391	6.14
Others	10.661	23.3	44.14	4.14	27.818	21.4	121.96	4.38

Source: UK National Statistics



Table C.6: Knitted Cotton T shirts – 1995 and 2000

Supply countries	1995				2000			
	Volume pcs. mn	% share	Value £million	Unit £/pc	Volume pcs. mn	% share	Value £million	Unit £/pc
All	207.11	100	372.32	1.80	-	-	-	-
Intra EU	74.81	36.1	146.74	1.96	-	-	-	-
Extra EU	132.3	63.9	225.58	1.71	276.5	-	560.61	2.03
Turkey	6.53	3.2	19.70	3.02	40.97	-	110.37	2.69
Morocco	-	-	-	-	21.349	-	22.78	1.07
Egypt	8.266	4.0	10.318	1.25	5.59	-	12.061	2.16
Mauritius	8.792	4.3	20.11	2.29	20.784	-	46.63	2.24
USA	2.497	1.2	10.217	4.09	3.066	-	12.037	3.93
India	6.323	3.1	11.655	1.84	13.292	-	23.232	1.75
Bangladesh	32.599	15.7	32.02	0.98	52.276	-	56.581	1.08
Sri Lanka	6.966	3.3	10.404	1.49	13.669	-	29.460	2.16
Singapore	-	-	-	-	5.451	-	12.060	2.21
China	-	-	-	-	6.048	-	20.022	3.31
Hong Kong	12.288	5.9	32.646	2.66	29.082	-	97.923	3.37
Others	48.03	23.1	78.509	1.63	64.93	-	117.45	1.81

Source: UK National Statistics

Table C.7: Men's Knitted Shirts not of Cotton; 1995 and 2000

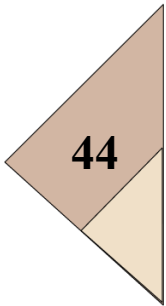
Supply source	1995				2000			
	Volume pcs mn	% share	Value £million	Unit £/pc	Volume pcs mn	% share	Value £million	Unit £/pc
All	29.247	100	61.435	2.10	34.445	100	82.626	2.40
Intra EU	1.256	4.3	8.237	6.56	1.641	4.8	11.338	6.91
Extra EU	27.991	95.7	53.198	1.90	32.804	95.2	71.288	2.17
Bangladesh	5.291	18	8.192	1.55	3.269	9.5	5.809	1.78
Turkey	-	-	-	-	1.509	4.4	6.379	4.23
Sri Lanka	3.202	10.9	5.474	1.71	1.856	5.4	4.278	2.30
Philippines	2.749	9.4	3.527	1.28	5.356	15.5	5.19	0.97
China	4.572	15.6	8.534	1.87	2.474	7.2	8.875	3.59
Hong Kong	2.229	7.6	5.459	2.45	1.574	4.6	4.952	3.15
Indonesia	2.787	9.5	6.625	2.38	-	-	-	-
Others	8.417	29	23.624	2.81	18.407	53.4	47.143	2.56

Source: UK National Statistics

Note: The above tables are drawn from the 2003 report "Post-MFA Development Strategy and Technical Assistance for the RMG Sector", by Gherzi Textil Organization (GTO), Zurich, Switzerland, to the Ministry of Commerce, Government of Bangladesh.

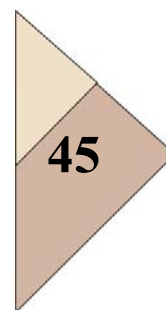
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