



UNIVERSITI PUTRA MALAYSIA

**IMPACTS OF TRADE LIBERALISATION ON
TRADE PERFORMANCE IN BANGLADESH**

MOHAMMAD MONJURUL HOQUE

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**IMPACTS OF TRADE LIBERALISATION ON
TRADE PERFORMANCE IN BANGLADESH**

By

MOHAMMAD MONJURUL HOQUE

**Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia,
in Fulfilment of the Requirements for the Degree of Doctor of Philosophy**

June 2007



DEDICATED

To my mother and father, my wife Nazma and children Riashad and Alifa



Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfilment of the requirement for the degree of Doctor of Philosophy

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June 2007

Chairman: Associate Professor Zulkornain Yusop, PhD

Faculty: Economics and Management

Experiencing trade imbalances and low GDP growth for long; realising benefits, theoretical and empirical supports to trade liberalisation for trade performance; Bangladesh has been liberalising its trade regime since 1992 for higher trade performance. However, still there is growing concern about its impact on trade performance. Therefore, the general objective of the study is set to evaluate and analyse the impacts of trade liberalisation on trade performance in Bangladesh. The study has developed a theoretical framework in which liberalisation can contribute to trade performance. Empirically, to capture the impacts of liberalisation on trade performance, three trade equations namely import demand, exports supply and trade balance functions for Bangladesh are estimated. Recent econometric methodology, the ARDL 'Bounds test' approach to cointegration is applied with annual time series data from 1972-73 to 2004-05 for estimation.

Empirical results suggest that the variables in the aggregate import function is cointegrated, and the economy of Bangladesh is quite open in aggregate import.



Trade liberalisation dummy impacts positively and import duty impacts negatively on aggregate import. Liberalisation interaction with price decreases import and hence improves trade balance, while interaction with income increases import and hence worsens trade balance. Import duty as a measure of liberalisation impacts negatively higher on import of capital goods compared to others; indicate that Bangladesh is following import liberalisation focused to the import of capital goods.

Liberalisation impacts positively on aggregate export. Capital stock as measure of technology transfer does not have any significant impact on aggregate export in the long run. Liberalisation impacts greatly on export of RMG. Capital stock impacts positively on export of RMG while negatively on export of shrimp, jute goods and raw jute; implies that investment is diverting to RMG sector from other areas; which is a reflection of the on-going liberalisation policy pursued by Bangladesh.

Reduction of import duty worsens trade deficit in the short run while improves in the long run. Increase in liberalisation, reduction or withdrawal of export duty both contribute to improve trade deficit. Deterioration in the terms of trade worsens trade deficit in the short run, while improves in the long run. Import and trade deficit are largely influenced by increase in income. Therefore, trade liberalisation and other policy options should be fine tuned consistently in line with price stability, increase in absorption and develop backward linkage industries domestically for higher export performance and to improve trade imbalances in Bangladesh.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Doktor Falsafah

**KESAN-KESAN LIBERELASI PERDAGANGAN
KE ATAS PRESTASI PERDAGANGAN DI BANGLADESH**

Oleh

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Sudah lama mengalami ketidakseimbangan perdagangan dan pertumbuhan KDNK yang rendah; menyedari faedah-faedah akibat daripada sokongan teori juga empirik terhadap liberelasi perdagangan untuk mencapai prestasi perdagangan; Bangladesh telah meliberelasikan rejim perdagangannya sejak 1992 untuk mencapai prestasi perdagangan yang lebih tinggi. Walaubagaimanapun, masih ujudnya kebimbangan yang kian menambah mengenai kesannya liberelasi terhadap prestasi perdagangan. Maka objektif am kajian ini adalah untuk menilai dan menganalisis kesan liberelasi perdagangan ke atas prestasi perdagangan di Bangladesh. Kajian ini telah mencapai sebuah kerangka teori dalammana liberelasi boleh menyumbang kepada prestasi perdagangan. Secara empiric, untuk menangkap kesan keliberelasian ke atas prestasi perdagangan, tiga persamaan perdagangan khususnya, permintaan impot, penawaran expot dan fungsi imbalan perdagangan untuk Bangladesh telah dianggarkan. Data siri masa tahunan dari 1972-73 hingga 2004-05 telah diguna dengan kaedah ekonometrik terkini, iaitu pendekatan ARDL “Ujian Batasan” (ARDL “Bounds test”) untuk kointegrasi bagi mencapai anggaran.

Hasil empirik mencadangkan bahawa angkubah-angkubah dalam fungsi impot agregat adalah berkointegrasi, dan ekonomi Bangladesh adalah agak terbuka kepada impot agregat. Dami liberelasi perdagangan berkesan positif dan cukai impot berkesan negative terhadap impot agregat. Interaksi liberelasi dengan harga mengurangkan impot dan seterusnya menambahbaikimbangan perdagangan, manakala interaksi bersama pendapatan menambahkan impot dan seterusnya memburukkanimbangan perdagangan. Sebagai suatu pengukur liberalisasi, cukai impot amat berkesan negative terhadap impot barangan modal, berbanding dengan barangan lain. Ini menunjukkan Bangladesh sedang mengamali liberelasi impot yang bertumpukan impot barangan modal.

Liberelasi berkesan positif terhadap expot agregat. Stok modal, sebagai pengukur pengagihan teknologi, tidak menunjukkan sebarang kesan signifikan terhadap expot agregat di jangka panjang. Liberelasi mempunyai kesan besar ke atas expot RMG. Stok modal berkesan positif terhadap expot RMG tetapi berkesan negative terhadap expot udang, barangan jute dan jute mentah; ini membayangkan bahawa pelaburan sedang menyusur ke sector RMG dari sector lain; dan seterusnya mencerminkan keadaan yang konsisten dengan polisi liberelasi yang sedang diikuti oleh Bangladesh.

Pengurangan cukai impot memburukkan defisit perdangan pada jangka pendek tetapi menambahbaikinya pada jangka panjang. Bertambahnya liberelasi dan pengurangan atau penarikan cukai expot, kedua-duanya menyumbang kepada bertambahbaikinya defisit perdagangan. Pemburukkan dalamimbangan perdagangan memburukkan lagi defisit perdagangan dalam jangka pendek tetapi menambahbaikinya dalam jangka panjang. Defisit impot dan perdagangan kebanyakannya dipengaruhi dengan

bertambahnya pendapatan. Maka, liberelasi perdagangan dan opsyen polisi lain harus diperincikan secara sesuai supaya ianya sentiasa konsisten selaras dengan kestabilan harga, pertambahan resapan an juga membangunkan industri rantaian hulu tempatan untuk mencapai prestasi eksport lebih tinggi dan untuk menambahbaik ketidakseimbangan perdagangan di Bangladesh.

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DECLARATION

I hereby declare that the thesis is based on my original work except for quotations and citations which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at UPM or other institutions.

MOHAMMAD MONJURUL HOQUE

Date: 2 JULY 2007

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LIST OF ABBREVIATIONS

ADF	Augmented Dickey Fuller
AIC	Akaike Information Criterion
ARCH	Autoregressive Conditional Hetero
ARDL	Autoregressive Distributed Lag
B	Biasness
BBS	Bangladesh Bureau of Statistics
BSTI	Bangladesh Standard and Testing Institute
C	Column
CET	Constant Elasticity of Transformation
CGE	Computable General Equilibrium Model
CIC	Community Indifference Curve
c.i.f.	Cost, Insurance and Freight
CPI	Consumer Price Index
CUTS	Consumer Unity and Trust
DAP	Di Ammonium Phosphate
DF	Dickey-Fuller
ECM	Error Correction Model
ECT	Error Correction Term
EER _m	Effective Exchange Rate Paid by Importers
EER _x	Effective Exchange Rate Received by Exporters
EPB	Export Promotion Bureau
EPZ	Export Processing Zone
ERP	Effective Rate of Protection



FE	Fixed Effect Method
f.o.b.	Free on Board
GAMS	General Algebraic Modeling System
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GMM	Generalised Method of Moments
GNP	Gross National Product
GoB	Government of Bangladesh
HDI	Human Development Index
HDR	Human Development Report
HO	Heckscher-Ohlin Theory of International trade
HS	Harmonise System
IFS	International Financial Statistics
IT	Information Technology
IIT	Intra-industry Trade
ILO	International Labor Office
IMF	International Monetary Fund
LDC	Least Developed Country
M	Import
MOP	Muriat of Potash
NBR	National Board of Revenue
NTB	Non Tariff Barriers
NTMs	Non Tariff Measures
NX	Net Export
NY	New York



OLS	Ordinary Least Square
PMC	Papageorgiou, D., Michaely, M. and Choksi A.
PP	Phillips-Perron
PPF	Production Possibility Frontier
PR	Premium
QR	Quantitative Restriction
REER	Real Effective Exchange Rate
RER	Real Exchange Rate
RMG	Ready Made Garments
RPL	Relative Price Level
SAL	Structural Adjustment Lending
SAPTA	South Asian Preferential Trading Agreement
SBC	Schwartz Bayesian Criterion
S & D	Special and Differential Treatment
S-W	Sachs and Warner
TB	Trade Balance
TDR	Trade development Report
TIR	Trade Intensity Ratio
Tk.	Taka (Bangladesh currency)
TOT	Terms of Trade
TSCS	Time Series Cross-Section Method
TSP	Try Super Phosphate
UECM	Unrestricted Error Correction Model
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development



UNU	United Nations University
UPI	Unit Price Index
UPM	University Putra Malaysia
USA	United States of America
US	United States
VAR	Vector Autoregression
VAT	Value Added Tax
VECM	Vector Error Correction Model
WB	World Bank
WDR	World Development Report
WTO	World Trade Organisation
X	Export



CHAPTER 1

INTRODUCTION

1.1 Background of the Study

In the current era of globalisation, trade liberalisation emerges as one of the most serious policy concern for the government of the countries all over the world for their economic growth and development. It is claimed that international trade enables each country to specialise in goods and services by stimulating competition and promoting technological change based on “*comparative and competitive advantage*” and consumers will be able to consume more quantity and better quality products at cheaper prices under a globalize economy and therefore human welfare will be increased (Gupta 1997; World Bank 2002). Globalisation is a process, which is driven by an increasing liberalisation of restrictions and increasing openness on the mobility of goods, services, capital and technological knowledge (Gupta 1997). Therefore, globalisation has strongly embraced trade liberalisation as one of the leading components for global economic integration and human welfare. Trade liberalisation is the pioneering component and has come first in the sequence of deregulation of the world economy under globalisation, followed by foreign investment and financial liberalisation (Nayyar 2001).

Debt crisis in the early 1980s was one of the most important arguments for trade reform in many developing countries. Due to debt crisis, in 1980s the developed countries (USA, UK, Canada, Germany, Japan, France etc) along with GATT, IMF and WB as proponents of free trade assumed that trade liberalisation will ultimately



improve exports and growth, particularly for developing countries. Hence, they began to recommend trade liberalisation for developing countries in terms of trade barriers reduction and opening of economy to foreign investors as part of structural adjustment programs to obtain fund for their development strategies for economic growth and development. They were also pushing for trade liberalisation as an “engine of growth”; with caution against blind use of liberalisation measures to promote growth in developing countries and point to a number of caveats including the importance of initial conditions in a country, the level of human development and the quality of national innovation systems (Edwards 1993, p1359; Greenway 1997; Gupta & Chawdhry, N.K. 1997; Imada 1993; Jeffrey & Howard 1996; Ramakrishna, G. 2002 and Stephen 2000).

Moreover, changes in the intellectual outlooks towards the benefits of market-oriented economy due to success in the few East Asian countries for development with more outward-oriented strategies; failure of the import-substitution protectionist policy for development in many developing countries in the 1950s and 1960s; and desire for global economic integration have played important role for initialising the process of trade liberalisation (Edwards 1993). Jeffrey Sachs (1987) highlighted that trade liberalisation is an important component of successful outward oriented strategies and has argued that the success of the East Asian countries was to a large extent due to an active role of government in promoting exports in an environment where imports had not been fully liberalised and macroeconomic equilibrium especially in fiscal areas was fostered (Edwards 1993). Finally, in 1994, commitments as member of WTO also lead developing countries for further trade liberalisation (ILO 2001; Santos-Paulino 2002).

