

BIMSTEC- Japan Cooperation in Trade and Investment

Bangladesh Perspective

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**Centre for Studies in International Relations
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A.K.M. Atiqur Rahman*

Abstract: The present paper aims at making an elementary analysis of the prospects of BIMSTEC-Japan cooperation from the perspective of Bangladesh. According to the author, BIMSTEC-Japan cooperation may bring mutual benefits for both BIMSTEC countries and Japan. There is potential for cooperation in trade in goods and services, investment and other areas. However, according to the author, the potential gain is neither symmetric nor guaranteed for all member countries. This paper concludes that although Bangladesh is an LDC and much smaller in size compared to India, still it has enough potential to gain from BIMSTEC-Japan cooperation because of the fact that Japan is a major trading partner as well as a major development partner of Bangladesh. In all these cases BIMSTEC-Japan cooperation can bring benefits to Japan as well. Finally, according to the author, appropriate policies and actions are needed to reap the potential benefits out of BIMSTEC-Japan cooperation.

1: Introduction

Regionalism has appeared as a key feature of the current international order. While origin of regionalism goes back to formation of EEC in late 1950s, it has proceeded further in several ways. The past decade has witnessed a renewed interest in regional cooperation as an attractive complementary strategy to multilateralism. Developing countries and LDCs are taking regionalism not only as a means of fostering trade among the member countries, but also as a means to enhance the development process through economic cooperation. Regional cooperation is viewed not only as a means to face the challenge of globalization more boldly but also exploit the

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opportunities of the developing countries more effectively. Regional economic cooperation arrangement among five Indian Ocean rim countries, viz Bangladesh, India, Myanmar, Sri Lanka and Thailand along with Nepal and Bhutan, two landlocked countries, is one of the latest additions in the wave of regionalism, which is known as BIMSTEC.

BIMST-EC (Bangladesh, India, Myanmar, Sri Lanka, and Thailand Economic Cooperation) was originally launched as BIMST-EC with the adoption of the declaration at a Ministerial Meeting held in Bangkok in 1997. Following the admission of Myanmar as a member later in the same year, it was renamed as BIMST-EC. The first meeting of Commerce and Economic Ministers of the Grouping, held in 1998 in Bangkok, decided that BIMST-EC should aim at and strive to develop into a free trade arrangement and that it should focus on activities that facilitate trade, investment, and promote economic cooperation. In 2004 Nepal and Bhutan have been formally incorporated as members of the BIMST-EC through the decision of Foreign Ministers' Summit, held in Thailand. BIMST-EC is renamed as BIMSTEC that stands for *Bay of Bengal Initiative of Multi-Sectoral and Technical Cooperation*.

BIMSTEC is an important forum for regional economic cooperation. More than 1.3 billion people reside in the BIMSTEC countries. The group involves some of the small and less developed country of Asia along with a middle income country (Thailand) and the second most populated country in the world (India). The complementarities among the members are substantial as they are at different level of economic and industrial development along with different natural resource endowments. Although SAARC is the first initiative in this region to enhance economic cooperation, its limited success obviates the importance of alternative forum. BIMSTEC is an important initiative in this regard as it is able to avoid Indo-Pakistan political rivalry. BIMSTEC provides a link between South and East Asia and can be a potential hub to foster cooperation in Asia. Since most of the BIMSTEC countries share common maritime boundary, this has strategic importance as well.

After the formation of BIMSTEC, it has identified six areas for strengthening economic cooperation among the member countries: trade and investment, technology, transport and communication, tourism, energy, and fisheries. BIMSTEC got a fresh momentum in 2004 with the expansion of membership and signing of the Framework Agreement for a Free Trade Area (FTA). This FTA covers liberalization, promotion and facilitation of trade in goods and services, investments, as well as broader economic cooperation.

BIMSTEC countries are at different level of development implying reasonable complementarities. This provides a solid ground for trade and economic cooperation. However, still the BIMSTEC grouping lacks a partner that is highly advanced economically and technologically. Japan being one of the economically advanced countries in the world is located in East Asia which has very cordial relationship with BIMSTEC countries. Japan is a significant investor around the world and it is also among the largest donors bilaterally and multilaterally. Japan is seen as a vibrant partner of BIMSTEC as it has already appeared as a robust economy with pro-Asian policies in trade and investment (CSIRD, 2006). Hence BIMSTEC-Japan cooperation became an agenda of utmost importance.

BIMSTEC-Japan cooperation has important implications for Bangladesh. Since the inception of Bangladesh, Japan has been a very good friend of Bangladesh in terms of both political and economic relations. Japan had been the most important bilateral donor and one of the important multilateral donors to Bangladesh. Japan is also one of the important trading partners of Bangladesh. Japan has contributed a lot in infrastructure development of Bangladesh. Hence, BIMSTEC-Japan cooperation may bring important dimension for Bangladesh. BIMSTEC-Japan cooperation may turn out to be quite important form Bangladesh perspective.

The present paper aims at making an elementary analysis of the prospects of BIMSTEC-Japan cooperation from Bangladesh perspective. It starts with a brief analysis of the general potential for BIMSTEC-Japan cooperation in trade and investment. It then presents

the current trade and investment regime in Bangladesh. On this backdrop, the paper then discusses the issue of BIMSTEC-Japan cooperation in trade and investment from Bangladesh perspective.

2. BIMSTEC and Japan: An Overview of Economic Status

BIMSTEC countries inhibits more than one fifth of world population. The largest country in terms of population in BIMSTEC is India, followed by Bangladesh. India alone counts for more than 80% per cent of Population and more than 70% of GDP of BIMSTEC. Japan, on the other, has only 10% of BIMSTEC population, but its GDP is about 5 times of BIMSTEC.

The nature and extent of economic cooperation among the countries within a regional group depends largely on the diversity of the economies and complementarities in the production structure. BIMSTEC countries show a moderate level of diversity in terms of level of development and the structure of the economy. According to the World Bank classification, four out of seven BIMSTEC countries are low income countries viz. Bangladesh, Nepal, Bhutan and Myanmar. India, Sri Lanka, Thailand are lower middle income developing countries. On the other, Japan is at the upper end of the high income countries. Japan's per capita income in terms of current price is about sixty times that of BIMSTEC countries. Japan appears to be a quite valuable potential partner of BIMSTEC in economic cooperation because of its level of economic and technological development. Although, the growth rate Japan is much lower than BIMSTEC countries, it may also look for how its growth can be enhanced through deeper economic cooperation with BIMSTEC.

In terms of the structure of the economy, Bangladesh, India and Nepal are not that different. As indicated in Table 1, service sector contributes about half the GDP, industry contributes more than one fourth and agriculture contributes the rest. Indian economy is services driven, whereas Myanmar and Nepal are agriculture dominated economies, with a very little share of industry. Thailand is an industry-driven country, with a low share of agriculture. Thus, economic

Table 1: Basic Macroeconomic Indicators of BIMSTEC Countries and Japan

	GDP, 2004 (billion US \$)	GDP growth Rate, (%) (2000-04)	Population 2004 (million)	Sectoral Share in GDP (%)			Savings (as % of GDP)	Investment (as % of GDP)
				Agriculture	Industry	Services		
Bangladesh	56.8	5.1	140.5	21	27	53	18.0	23.0
Bhutan	0.6	6.7	0.9	33	40	27		
India	691.9	6.2	1079.7	22	26	52	22.0	23.3
Japan	4623.4	1.3	127.8	1	30	68	26.0	24.0
Nepal	6.7	2.6	25.2	40	23	37	14.0	26.0
Sri Lanka	20.1	3.8	19.4	17	25	58	22.0	19.0
Thailand	163.5	5.3	62.4	10	44	46	32.0	25.2

Source: Computed from World Development Indicators 2006, World Bank

complementarities among the BIMSTEC countries are quite large and it would be enhanced if Japan is included in the group. Although share of agriculture is low, Japan has shown considerable innovation and improvement in agriculture from which other can learn. BIMSTEC countries may benefit a lot in modernizing their agriculture sector by appropriate cooperation with Japan. Bangladesh, India and Nepal have negative saving-investment gap. In contrast, Thailand, Sri Lanka and Japan have positive saving-investment gap. Saving rate is highest in Thailand and lowest in Nepal (ignoring Bhutan and Myanmar).

Table 2: Poverty, Inequality and Indicators of Human Development: 2004

	PCI at PPP adjusted \$	Incidence of poverty* (%)	Gini Index of income /consumption inequality	Life Expectancy at Birth		Adult Literacy
				Male	Female	
Bangladesh	1,980	49.0	0.31	62	63	41
Bhutan	-	-	-	62	65	-
India	3,100	28.6	0.33	63	64	61
Japan	30,040		0.25		78	85
Myanmar	-	-	-	55	60	90
Nepal	1,470	42.0	0.36	60	60	49
Sri Lanka	4,000	25.0	0.38	72	76	90
Thailand	8,020	13.1	0.40	67	72	93

Note: *percentage of people below the national poverty line

Source: World Development Report 2006.

Poverty is rampant in South Asia. Incidence of poverty is very high in Bangladesh and Nepal. India has been able to reduce poverty below thirty percent. Poverty is moderate in Sri Lanka and Thailand. There is a clear negative relationship between PPP adjusted per capita income and the incidence of poverty within the BIMSTEC countries. Hence, enhancing growth would be the major objective of cooperation among the BIMSTEC countries. Many of the BIMSTEC countries, particularly from South Asia are also lagging in terms of other indicators of human development (see, Table 2). Physical infrastructure is also poor in most of the South Asian countries. In particular

electricity consumption per capita is alarmingly low in Myanmar and Bangladesh (Rahman and Rahman, 2004).

Table 3: External Sector Indicators of BIMSTEC Countries and Japan: 2004

	Export (US\$ million)	Import (US\$ million)	Trade- GDP ratio	Net FDI Inflow (US\$ million)	Gross FDI - GDP Ratio	PV of external debt as a % of GNI, 2003
Bangladesh	8,150	12,100	35.7	102.5	0.2	23
Bhutan				0.2	-	
India	72,530	95,156	24.2	4270.0	0.8	19
Japan	569,490	454,530	22.1	6238.3	1.0	.
Nepal	756	1,877	39.3	1.5	0.3	38
Sri Lanka	5,800	7,950	68.4	228.7	1.4	50
Thailand	97,701	95,384	118.1	1949.2	1.7	41

Source: Computed from World Development Indicators 2006, World Bank

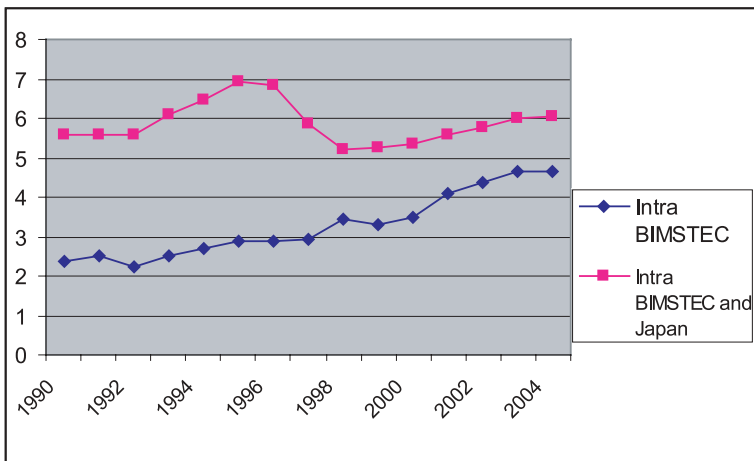
Thailand and Sri Lanka are the most open countries in terms of trade intensity among the BIMSTEC countries. However, trade openness of most the BIMSTEC countries have enhanced over the years because of the trade policy reforms. In terms of FDI inflows, Thailand, Sri Lanka, and India re performing better. FDI inflow is very low in Bangladesh and Nepal. Except India, developing countries (i.e. Thailand, Sri Lanka) have a higher indebtedness in terms of foreign borrowing, while indebtedness of LDCs is relatively lower (see, Table 3).

3: Trade between BIMSTEC and Japan

Tables 4, 5 and 6 provide major trading partner of BIMSTEC countries and their exports and imports. BIMSTEC countries though represents more than one fifth of worlds population, there combined international trade counts only around 1.4% of global trade. India and Thailand are two important players in international trade in BIMSTEC. Table 4 shows that major trading partners (top 5 export and import partners) of the BIMSTEC countries. The major trading partners of the BIMSTEC countries appear to be developed countries along with

few Asian countries such as China, Hong Kong, Malaysia, and India. It is important to note that except the imports of Bangladesh and Sri Lanka from India and Myanmar's export to India, none of BIMSTEC countries appear among the top export and import partners of the BIMSTEC countries. Although Japan is much smaller than India in terms of population, it is a major player in international trade. It is a very important trading partner for all the BIMSTEC countries except Nepal. Bangladesh, India, Nepal and Sri Lanka depend more on industrial countries for their export market, but they rely more on developing countries as their source of import. Thailand and Myanmar have greater reliance on developing countries for both their export and import.

Figure 1: Intra-BIMSTEC Trade (as a % of Total Trade) of the BIMSTEC Countries (including and excluding Japan)



Source: Calculated based on DOTS, IMF, Various issues

Intra-BIMSTEC trade is quite low, which is around 4% of their total international trade of the BIMSTEC countries. However, as shown in Figure 1, intra-BIMSTEC trade is increasing over time. Total international trade of these countries is also low (less than 1.5 percent of world trade), however, showing an increasing trend. Although intra-

Table 4: Major Trading Partners of BIMSTEC Countries and Japan: 2004

	1	2	3	4	5	
Bangladesh	Export Import	US India	Germany Japan	UK China	France Singapore	Italy Hong Kong
India	Export Import	US US	UK Belgium	Japan Japan	Hong Kong Germany	Germany UK
Myanmar	Export Import	US Singapore	India China	Singapore Malaysia	<i>Japan</i> <i>Japan</i>	China Indonesia
Nepal	Export Import	India India	US China	Germany UAE	UK Singapore	Canada Hong Kong
Sri Lanka	Export Import	US India	UK Japan	Germany Singapore	<i>Japan</i> Korea	France Hong Kong
Thailand	Export Import	US Japan	Japan US	Singapore Singapore	Hong Kong Malaysia	Malaysia Germany
Japan	Export Import	US US	China Canada	Korea Australia	Hong Kong New Zealand	Thailand Austria

Source: Authors construction based on DOTS, IMF.

Table 5: Import by BIMSTEC countries, 2004

Country	Total (million US \$)	BIMSTEC Countries (%)	BIMSTEC and Japan (%)	Developing Countries (%)	Industrial Countries (%)
Bangladesh	11590	18.0	23.3	69.5	20.8
India	99835.3	1.9	4.9	36.6	35.5
Nepal	1695.87	49.0	50.5	87.5	9.5
Myanmar	3454.33	25.9	29.3	91.3	7.7
Sri Lanka	7999.81	20.0	25.2	71.1	28.7
Thailand	92851.1	2.7	26.8	54.0	46.0
Japan	454864	8.3	8.3	65.5	34.4

Source: Author's calculation based on DOTS, IMF.

Table 6: Export from BIMSTEC Countries, 2004

Country	Total (million US \$)	BIMSTEC Countries (%)	BIMSTEC and Japan (%)	Developing Countries (%)	Industrial Countries (%)
Bangladesh	7585.6	1.3	2.1	8.6	78.0
India	75385.2	6.3	8.8	55.8	43.7
Nepal	625.64	48.0	49.1	51.9	45.0
Myanmar	3160.53	51.3	56.5	76.6	21.8
Sri Lanka	5766.83	7.4	10.1	28.8	70.1
Thailand	96244.6	2.2	14.1	50.4	49.2
Japan	565812	4.3	4.3	57.8	42.1

Source: Author's calculation Based on DOTS data

BIMSTEC export and import vary widely, share of intra-BIMSTEC trade is quite low for the two major trading partners such as India and Thailand. Inclusion of Japan with the BIMSTEC countries increases volume of intra-BIMSTEC+Japan trade, for many BIMSTEC countries, viz Bangladesh, India, Thailand, Sri Lanka. Thailand has noticeable amount of trade with Japan. However, intra-BIMSTEC trade including Japan as a percent of their total trade does not show any increasing trend. Thus, there may be scope for further enhancement of trade of BIMSTEC countries with Japan.

Although Japan is the third major import source country of Bangladesh, Bangladesh's export to Japan is quite limited. BIMSTEC-Japan trade cooperation should be effectively utilized enhance Bangladesh trade with Japan with due attention to the current trade deficit of Bangladesh with Japan.

4: Complementarities and Potentials for Trade between BIMSTEC and Japan

BIMSTEC economies have reasonable complementarities among themselves. This provides scope for expansion of trade within the member countries. Rahman and Rahman (2004) commented that there is a reasonable amount of trade complementarities among the BIMSTEC countries in terms of revealed comparative advantage (RCA) and the factor intensity of export. Given that Japan is a developed country, inclusion of Japan is expected to increase trade complementarities. All of the BIMSTEC countries except Thailand lag far behind in terms of high technology export (see, Table 7, and RIS, 2004). On the other hand, Japan being a developed country, concentrates much more in production and export of high tech goods. Hence, BIMSTEC-Japan cooperation in trade has great potential to enhance trade. It is also supposed to enhance intra-industry trade, particularly between Thailand and Japan as both the countries have large industrial sector.

Table 7: Export of Manufacturing and High-Tech Goods from BIMSTEC Countries and Japan, 2004

	Manufacturing Export (as a % of total export)	High-tech export (as a % of manufacturing export)
Bangladesh	89	0
India	77	5
Japan	94	24
Sri Lanka	74	1
Thailand	75	30

Source: World Development Indicators 2006, World Bank

Gravity model of international trade may be used to for simulation of effect of PTA trade and FTA. While Gravity model has been

Table 8 (a): Estimated Increase in Regional Import due to PTA and/or FTA

	Increase in Import with 50% tariff cut (million US \$)		Percentage increase in Import with 50% tariff cut (%)		Increase in Import with 100% tariff cut (million US \$)		Percentage increase in Import with 100% tariff cut (%)	
	BIMSTEC	BIMSTEC-Japan	BIMSTEC	BIMSTEC-Japan	BIMSTEC	BIMSTEC-Japan	BIMSTEC	BIMSTEC-Japan
Bangladesh	532.69	708.40	30.94	30.95	1065.4	1416.81	61.87	61.91
India	872.51	2312.86	53.63	54.25	1744	4624.7	107.19	108.48
Japan		670.75		4.61	1341.5	1341.5		9.23
Myanmar	42.81	53.23	7.61	7.62	85.62	106.45	15.22	15.24
Nepal	80.11	84.50	30.54	30.58	160.21	168.99	61.07	61.16
Sri Lanka	165.43	225.73	13.45	13.45	330.22	450.81	26.84	26.86
Thailand	296.67	3252.97	16.18	16.18	593.34	6506.04	32.37	32.37
Total	1990.22	7308.44	27.50	16.67	5320.29	14615.3	54.98	33.34

Source: Authors calculation based on Bhattacharya (2005)

Table 8 (b): Estimated Increase in Regional Export due to PTA and/or FTA

	Increase in Export with 50% tariff cut (million US \$)		Percentage increase in Export with 50% tariff cut (%)		Increase in Export with 100% tariff cut (million US \$)		Percentage increase in Export with 100% tariff cut (%)	
	BIMSTEC	BIMSTEC-Japan	BIMSTEC	BIMSTEC-Japan	BIMSTEC	BIMSTEC-Japan	BIMSTEC	BIMSTEC-Japan
Bangladesh	40.15	43.03	51.22	33.13	80.30	86.06	102.44	66.26
India	894.76	1005.26	26.26	18.67	1789.51	2010.51	52.51	37.34
Japan		6910.6		35.64		13821.20		71.28
Myanmar	333.39	340.49	30.03	27.52	666.79	680.98	60.06	55.04
Nepal	216.39	216.75	64.66	63.53	432.79	433.52	129.33	127.07
Sri Lanka	166.86	175.86	61.88	40.84	333.73	351.73	123.76	81.68
Thailand	592.0	1231.5	38.39	9.49	1190.00	2469.00	77.17	19.03
Total	2243.55	9923.49	33.27	24.88	4493.12	19853.00	66.63	49.77

Source: Authors calculation based on Bhattacharya (2005)

extensively used since 1960s, many studies since 1980s developed the Gravity model based on general equilibrium framework. In most of the existing studies, the bilateral trade flows have been explained by GNP, GNP per capita, trade restrictive variables like tariff and non-tariff barrier, distance, adjacency, etc. Bhattacharya (2005) estimated the effect of tariff reduction on intra-BIMSTEC (including Japan) trade using the Gravity model adopted by Srinivasan and Caonero in a series of papers. The study simulates the increase in intra-BIMSTEC+Japan trade for four hypothetical scenario of tariff reduction (viz, 25%, 50%, 75%, and 100%) to have an indicative result for PTA and FTA. Tables 8(a) and 8(b) shows some of the summary results based on Bhattacharya (2005). The simulation results show that there will be substantial increase in trade through a PTA or FTA in the BIMSTEC region. Increase in trade volume out of PTA and FTA would be significantly higher if Japan is included in the BIMSTEC. Increase in trade out of PTA and FTA depends, among others, on current level of trade and tariff.

5. Investment in BIMSTEC

Cooperation in investment is among the BIMSTEC countries is important not only for stimulating overall investment and growth, but also for expansion of trade within the BIMSTEC region. Several BIMSTEC economies are quite small to undertake large activities that would be economically viable. Economic integration may provide a larger market to make investment worthwhile in many fields. There could be meaningful industrial restructuring as well based on the basis of availability of natural resource, human skills, and overall efficiency. Such restructuring requires investment cooperation among the members. This in turn will enhance intra-BIMSTEC trade. Investment cooperation in terms of joint venture and FDI could be quite helpful. BIMSTEC countries made progress in trade liberalization, but investment cooperation requires liberalization of investment regime as well.

Except Thailand and India, FDI in other BIMSTEC countries are quite low. Japan has been the major source of both FDI and ODA for BIMSTEC countries. However, Japan's FDI is much lower in South

Asia compared to that in South East Asia. BIMSTEC-Japan cooperation may increase overall FDI in BIMSTEC countries. India is a major recipient of FDI. However, India's outward FDI has been increasing in recent years. LDCs among the BIMSTEC country may gain from FDI from India

Table 9: Japan's Outward FDI to BIMSTEC Countries
(million US \$)

	Cumulative 1997-2004
Bangladesh	18
India	1,708
Myanmar	27
Nepal	4
Thailand	8,242
Sri Lanka	372
BISTEC	10,371
Asia	60,318
Total	352,536
BIMSTEC/Asia (%)	17.2
BIMSTEC / Total (%)	2.9

Source: Asher and Sen (2006)

Outsourcing would be quite important to BIMSTEC countries while looking for FDI from Japan as there are countries with different level of development. Thailand has already gained specialization in producing parts and assembling mechanical and electrical goods. Japan may outsource such activities in BIMSTEC countries increasingly.

Japan being a member of OECD countries is having a mature financial and banking sector. BISTEC-Japan cooperation may develop finance and banking sector in the region. This may also generate more funds for productive investment.

Infrastructure development is crucial for fostering trade and investment. Japan assisted in many of the large infrastructure project in the BIMSTEC countries. Therefore, BIMSTEC-Japan cooperation may foster further development in infrastructure sector.

6. Trade and Investment Regime in Bangladesh

As the foregoing analysis indicates that there is substantial scope for BIMSTEC-Japan cooperation in trade and investment. However, effectiveness of BIMSTEC-Japan cooperation from Bangladesh perspective will depend, among others, on the existing investment climate, and trade and industrial policies in Bangladesh. Although Bangladesh is a poor country lagging many aspects, it has made substantial progress in terms of trade liberalisation. Despite poor level of governance and high ‘cost of doing business’, Bangladesh may not be a reasonably attractive place for investment due to good policy and many other factors.

Trade Policy

With trade liberalisation process started since mid 1980s, Bangladesh initiated vigorous trade liberalisation in early 1990s under the structural adjustment programme. Trade liberalisation policy included reduction in tariff rates, simplification of tariff structure, minimising non-tariff barrier, simplification of trade laws, etc. For example, unweighted average tariff on import reduced from 47.4% in Fiscal Year (FY) 1993 to 13.5.0% in FY 2005 and import weighted tariff declined from 23.6% to 9.6% (Table 10). Top custom duty rate has been reduced from 350% in 1993 to 25%. As a result, trade ratio has increased from some 22% at beginning of the last decade to around 37% in the recent years. Quantitative restrictions in Bangladesh have also been reduced drastically over time (Table 11).

Table 10: Average Rate of Custom Duty in Bangladesh (%)

Fiscal Year	Unweighted Average	Import-Weighted Average
1992-93	47.4	23.6
1993-94	36.0	24.1
1994-95	25.9	20.8
1995-96	22.3	17.0
1996-97	21.5	18.0
1997-98	20.7	16.0
1998-99	20.3	14.1
1999-00	19.5	13.8
2000-01	18.6	15.1
2001-02	17.1	9.7
2002-03	16.5	12.4
2003-04	15.6	11.5
2004-05	13.5	9.6

Source: National Board of Revenue, Government of Bangladesh

The export promotion incentives designed in the trade policy continue to play a crucial role as complementary to the liberalisation process. The incentives ensure that export-oriented industries are able to access imported-inputs at world-prices, exporters are subsidised which enable them to compete from position of strength in the global market, investments in export-oriented industries are encouraged, and that foreign direct investment in export-oriented industries in the EPZs are promoted. These incentives have played a crucial role in enabling Bangladesh to achieve a robust annual export growth rate of more than 12% over the last one and half decade.

**Table 11: Removal of Quantitative Restrictions
(QRs at 4-digit HS) in Bangladesh**

Year	Total QRs in Place	As % of QRs in total no. of commodities	QRs for trade reasons	QRs for non-trade reasons
1986	478	38.54	429	49
1987	550	44.35	489	61
1989	433	34.91	355	78
1992	193	15.56	137	56
1994	109	8.79	40	69
1995-1997	120	9.67	28	92
1997-2002	124	10.0	28	96
2003-2006	45	3.62	4	41

Source: Import Policy Order of Different Years, Government of Bangladesh

Exchange rate policy in Bangladesh went through an evolution since its independence and eventually moved to a relatively liberalized system. Bangladesh adopted a moderately flexible exchange rate policy since mid 1979 when exchange rate was pegged with a basket of currency, British pound still being the intervention currency. In 1994, the government accepted the obligations embodied in IMF article VIII, making Taka convertible for current account transactions. In March 2003, floating exchange rate regime came into operation.

Bangladesh is a signatory to the WTO since its inception in 1995 and enjoys preferential treatment as a LDC. It is also playing an active

role in upholding LDC views in various negotiations, especially in the WTO, where Bangladesh has been traditionally the spokesman of the LDCs. Bangladesh is also affiliated with several regional trading arrangements such as Bangkok Agreement (now, renamed as APTA), SAFTA, BIMSTEC, among others.

FDI policy

While the first industrial policy after the inception of Bangladesh was very restrictive one for private sector participation and foreign investment, the policy has gone through rapid evolution over the years. The country now has a most pro-private sector industrial policy and a most liberal FDI regime. The country offers perhaps the most liberal FDI regime in South Asia with no prior approval requirements or limits on equity participation or restrictions on acquisition, repatriation of profits and income (World Bank 1999). There is neither any local content requirement, nor any technology transfer requirement, or any other requirement like this (IFD, 2003). Policy framework for foreign investment in Bangladesh is based on Foreign Investment (Promotion and Protection) Act, 1980 which provides for non-discriminatory treatment between foreign and local investment. Fully foreign-owned firms or joint ventures are in no way obliged to sell their shares through public issues, irrespective of the amount of the paid-up capital. Foreign investors or companies may obtain full working capital loans from local banks. The terms of such loans are determined on the basis of bank-client relationship.

Many fiscal and non-fiscal incentives are provided to foreign investors in Bangladesh (Table 12). In addition, there are a number of investment facilitation institutions in Bangladesh, all working to help entrepreneurs find land, execute deeds, get permissions done easily and guide them through the process. The first and foremost organisation in this regard is the *Board of Investment (BOI)* that works under the Prime Minister's Office. The major functions of BOI include undertaking investment promotion activities at home and abroad, providing all types of facilities for promotion of capital investment and rapid industrialisation, registration of industrial projects as well as royalty and technical assistance agreements, etc. BOI also runs a

One Stop Service Centre that provides with pre-investment counselling, utility services, solution of problems in case of any difficulty in clearing imported machinery under concessional rate of import duty and obtaining bonded warehouse facility. *Bangladesh Export Processing Zone Authority* has also been set up to help investors, specially the foreign investors. It provides land and utility services to investors and also looks after the day to day problems of investors. In addition, Bangladesh Small and Cottage Industries Corporation (BSCIC) also provides developed plots to investors for setting up industries at its industrial estates. Both BEPZA and BSCIC approves wherever necessary the payment of any royalties, technical know-how fees and appointment and payment of remuneration of foreign personnel

Table 12: Major Incentives Provided to Foreign Investors in Bangladesh

Fiscal Incentives	Non-Fiscal Incentives
<ul style="list-style-type: none"> ● Tax holiday ● Accelerated depreciation allowance instead of tax holiday ● Concessionary income tax in lieu of tax holiday and accelerated depreciation allowance ● Concessionary duty on imported machinery ● Avoidance of double taxation ● Remittance of royalty, technical for know how, technical Assistance fee 	<ul style="list-style-type: none"> ● 100 percent foreign equity allowed ● Unrestricted exit policy ● Full repatriation facilities of dividend and capital in the event of exit ● Permanent Residence Permit on investing US \$ 75, 000 and Citizenship Offer investing US \$ 500,000

Source: BOI (2004) through Rashid (2006).

Investment Environment

Overall investment climate in a country depends on many factor such as government policy, availability of labour and other resources at competitive price, infrastructure, governance in the public and private sector, macroeconomic performance, political stability etc. However, it is difficult make an objective assessment of investment climate because of objective data can not measure all of these. We focus some aspect of investment climate of Bangladesh as highlighted in

the *Investment Climate Survey* (ICS), and *Doing Business Database* of World Bank.

Despite a strong macroeconomic performance, investment climate is poor in Bangladesh because of poor infrastructure, lack of good governance, inadequate access to finance, weak human capital base, lack of technological innovation etc. According to ICS, most of the firms view electricity as the major problem as 73.2% of surveyed firms consider it as a major constraint. Other important constraints, as perceived by firms are corruption (57.9%), tax administration (50.7%), finance (45.7%), policy uncertainty (45.4%), crime (39.4%), tax rate (35.8%), etc. Inter-country comparison shows that Bangladesh is in worse condition in these indicators compared to other Asian countries like India, Pakistan, China, Indonesia, Malaysia, etc.

ICS data is mostly subjective, as it is based on perceptions of the firms. As opposed to this, *Doing Business Project* develop the indicators assess government rules and regulations and their impact on business from an objective measure of the variables. A composite Overall Doing Business Index is constructed from indices of 10 factors: starting a business, licensing procedure, employing workers, property registration, access to credit, protection of investors, paying taxes, trading across borders, contract enforcement, and closing a business. In terms of ease of doing business index, Bangladesh presently ranks 65th (see Table 13). This is the third lowest among the BIMSTEC countries. Bangladesh's position is much favourable among the Asian Countries. In particular, Bangladesh provides much better protection to investors and employing workers are quite easier here. Getting credit, starting a business, and licensing procedures are also better here than many countries. However, Bangladesh is one the worst performers in terms of property registration. It also performs poorly in terms of export-import procedures and tax paying procedures

The Japan External Trade Organization (JETRO, 2005) conducts a survey on investment related cost in 21 major Asian cities including Dhaka. The information of the survey is collected by overseas JETRO offices. In addition, local Japanese Chambers and Industries (or similar

Table 13: Ease of Doing Business Ranking in Selected Asian Countries: 2005

Country	Rank
Thailand	20
Nepal	55
Bangladesh	65
Sri Lanka	75
China	91
Vietnam	99
Philippine	113
Indonesia	115
India	116

Source: Doing Business Database, World Bank

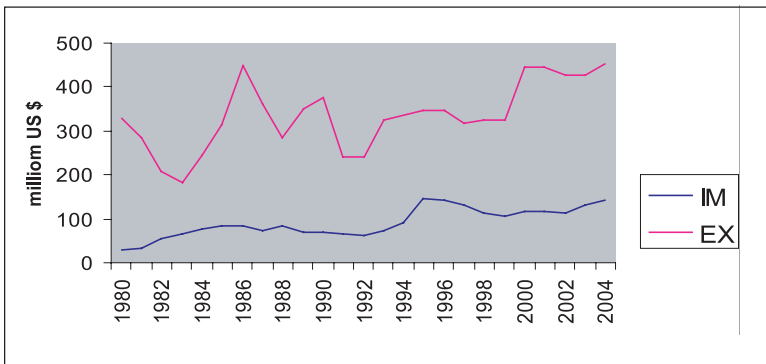
bodies) and several Japanese companies provide data. In some cases, local government organization and the related enterprises were consulted. Accordingly, the evaluation of the survey should be more accurate and strict from Japanese point of view. Hence, assessment of investment related cost in Dhaka (compared to other cities) based on this survey could more relevant for BIMSTEC-Japan investment cooperation from Bangladesh perspective. According to its 2005 report, Dhaka was one of the cheapest cities in terms of 8 components out of the 34 cost component considered. This includes workers wage, rental of the office/houses and industrial estates, water and electricity charges, basic cost of fixed phone, taxation on remittance of profit etc. However, Dhaka has disadvantages in container transportation cost, corporate income tax, cost of passenger cars, monthly basic payment on broadband internet service, new connection fee for fixed phone line, etc. Overall, the cost of business is not an exorbitant one in Dhaka from Japan's perspective. Very recently, Dhaka has become little more cost competitive due to reduction in investment cost marking a sign of improvement in investment environment.

7. Bangladesh and BIMSTEC-Japan Trade Cooperation

Japan is a major trading Partner of Bangladesh. In 2004, Bangladesh's export to Japan was about US\$ 130 million and import was about US\$ 450 million (Figure 2). Import from Japan to

Bangladesh counts as 5% of its total import, and about one fourth of its total import from the Industrial countries. Fruit and vegetables, textile and textile articles, raw skin and hide, footwear are major export items of Bangladesh to Japan, whereas vehicles and transport equipment, steel and metal, and chemicals are major import items of Bangladesh from Japan (see Table 14). Although Bangladesh's export to Japan is very low, it is about two-third of Bangladesh's export to BIMSTEC countries. Hence, BIMSTEC Japan cooperation may have important implications for bilateral trade between Bangladesh and Japan.

Figure 2: Japan's Trade with Bangladesh



Source: Author's calculation Based on DOTS data

Gravity model based simulation results show that inclusion of Japan increases volume of intra-BIMSTEC+Japan import of Bangladesh by a huge amount. However, it has a minimum affect on Bangladesh's export within the region. Given a large trade deficit of Bangladesh with BISTEC countries and that with Japan, any preferential trading arrangement in BIMSTEC-Japan countries will enhance Bangladesh trade deficit within the region. Net gain of such trade expansion will depend on relative magnitude of trade creating and trade diverting affect.

Rahman and Rahman (2001) showed that, despite a growing trade deficit of Bangladesh with India, it was welfare improving for

Table 14: Major Commodities Traded with Japan in 2004

Export of Bangladesh to Japan	Fish & crustaceans Value = \$18,806 Share = 3.57%	Raw hides & skin Value = \$17,703 Share = 3.36%	Textile and textile articles Value = \$14,355 Share = 2.72%	Footwear Value = \$5732 Share = 1.07%
Import by Bangladesh from Japan	Vehicles and transport equipment Value = \$210.64 m Share = 38.27%	Base metals and articles of base metal Value = \$ 99.72 m Share = 18.93%	Product of chemical or allied industries Value = \$ 18.90 m Share = 3.59%	

Source: Extracted from Bangladesh Bank Data

Bangladesh because such deficit was created mostly because of diversion of import to low cost Indian source from high cost import sources of developed countries. Import of some of the items from Japan was also substituted by cheaper Indian source. Thus, expansion of import from Japan due to FTA or PTA may have possibility of having some trade diversion effect.

Major items that Bangladesh imports from Japan are vehicles and transport equipment, base metals and articles of base metals, product of chemical or allied industries. Bangladesh is almost absolutely import-dependent for these commodities. Enhanced import does not seem to hurt any local competitors. However, it may affect import from other countries such as China, India, Hong Kong, etc. As the Japanese products are known for quality, increased import from Japan may have positive impact on Bangladesh. Import of better machineries from Japan is obviously good for our industries.

While about 80% of Bangladesh's export is directed to industrial countries, only 20% of its import is sourced from the same. Bangladesh enjoys huge trade surplus with United States and European Union. However, the scenario is quite opposite for the eastern countries like Japan and Australia. Bangladesh runs huge trade deficit with them. This issue needs to be explored and steps must be taken to enhance export to Japan under the framework of BIMSTEC-Japan cooperation. Export bundle to Japan needs to be diversified. Readymade garment and knitwear is the major export item of Bangladesh that counts more than three-fourths of total export of the country. However, export of RMG is quite limited to Japan. Japan relies on other East Asian countries for RMG. However, Bangladesh has also reasonably advanced towards high value RMG products, which could be exported to Japan as well. It is to note that duty free access in Canada increased Bangladesh's RMG export manifold. RMG export has started to increase even in Australia, albeit moderately, after duty free access is allowed to Bangladesh. Hence, duty free access in Japan may enhance RMG export of Bangladesh to Japan. Steps should be taken to explore market for other Bangladesh products as well. Trade facilitation and trade

promotion measures must be taken under the framework of BIMSTEC-Japan trade cooperation to increase export from Bangladesh to Japan. This is also essential to keep the trade deficit of Bangladesh with Japan within a tolerable range.

Importance of services in total trade of Bangladesh has been increasing. Particularly manpower export from Bangladesh has shown a robust growth in the recent years. Remittance from manpower export now stood at half of merchandise export. Hence, Bangladesh should provide cardinal importance on the possibility of manpower export in any form of trade cooperation while such opportunity exists. Japan is a developed country with aging population. Japan has shortage of its own manpower to run all its economic activities. It has to rely on services of the people from other countries. Bangladesh is a country with surplus manpower. While India is renowned for skilled manpower in IT, health services, etc, in the recent years, Bangladesh has also been making improvement in producing skilled manpower in different fields. Thus, BIMSTEC-Japan cooperation in service trade will create immense opportunities for Japan and other member countries like India and Bangladesh. Export of skilled and unskilled manpower to Japan may bring significant benefit to Bangladesh.

8. Bangladesh and BIMSTEC-Japan investment Cooperation

There is long history of excellent Bangladesh -Japan bilateral relationship. Japan has appeared as a major trading partner of Bangladesh. Japan is also the single most important country as a source of foreign aid to Bangladesh. It channels foreign aid to Bangladesh through bilateral assistance scheme as well through international financial institutions. Disbursement of bilateral aid of Japan to Bangladesh had been around 40% of total bilateral aid disbursed and about 20% of total aid disbursed in Bangladesh. However, the aid flow recently has declined. Despite such importance in terms of official development assistance (ODA), Japan's FDI to Bangladesh had been quite negligible. While government of Japan had worked to be an important development partner of Bangladesh, private investors of Japan kept a hands-off policy to Bangladesh. BIMSTEC-Japan

cooperation may be meaningfully addressed to break this deadlock and accelerate FDI from Japan to this country.

Japan is an important player in the world as a source of FDI as well as ODA. Concomitantly it has been the major source of both FDI and ODA for many BIMSTEC countries. However, FDI from Japan is very unevenly distributed among the BIMSTEC countries. During the period 1997-2004, cumulative FDI from Japan to Thailand exceeded US\$ 8 billion. India received about US\$ 1.7 billion of FDI from Japan. In contrast, Bangladesh received only US\$ 18 million from Japan during the same period (see, Table 15). As we have discussed in the previous sections that Bangladesh have one of the most liberal and very attractive FDI policies, and also has proceeded much in terms of trade liberalization. It ranks quite well in terms of “Ease of Doing Business”. JETRO survey, which is more relevant for Japanese investors, shows that Dhaka is not that bad in terms of cost of trade and investment compared to other Asian cities. FDI in Bangladesh is growing since mid 1990s, although there is year to year

Table 15: Importance of Japan in Foreign Aid to Bangladesh

	Disbursed Aid from Japan (1)	Total Bilateral Aid Disbursed (2) (US\$ million)	Total Aid Disbursed (3)	(1) as a % of (2)	(1) as a % of (3)
				(%)	
1994-95	356.5	918.0	1739.1	38.8	20.5
1995-96	331.1	756.7	1443.8	43.8	22.9
1996-97	368.2	712.2	1481.2	51.7	24.9
1997-98	171.9	488.6	1251.4	35.2	13.7
1998-99	235.0	654.2	1536.1	35.9	15.3
1999-00	390.7	795.2	1588.0	49.1	24.6
2000-01	316.2	696.5	1368.8	45.4	23.1
2001-02	287.4	708.7	1442.2	40.6	19.9
2002-03	243.4	677.5	1585.0	35.9	15.4
2003-04	79.4	506.1	1033.5	15.7	7.7
2004-05	45.0		1491.5		3.0

Source: Flow of External Resources to Bangladesh, Ministry of Finance

fluctuation. Considerable amount of FDI to Bangladesh is coming from Asian countries. Investors from other Asian countries are showing growing interest about investing in Bangladesh. Japan being the major source of FDI in Asia, has huge potential for investment in Bangladesh as well.

One of the reasons for scanty amount of FDI from Japan to Bangladesh is the perceived limited size of the market in the country. However, market is already growing due to reasonably high growth rate of GDP and a growing middle class in Bangladesh. There is ample scope of Japanese FDI and joint venture in Bangladesh in IT, consumer durables, light to moderate engineering etc. Free trade among the BIMSTEC countries will enable marketing of goods beyond the national boundary and reach other neighboring BIMSTEC countries, and thus effectively ensures a larger market for the goods produced out of FDI. Bangladesh may serve as a hub for outsourcing and assembling of Japanese goods by using cheap labor, growing human skill, and other facilities that may cater needs of neighbor countries through preferential or free trade agreement under BIMSTEC.

Bangladesh usually implements large infrastructure project under public sector. However, due to economic reforms, environment for infrastructure development has been created in the recent years. Private investment, including FDI is encouraged in many fields of infrastructure development. Japan has a long history of providing financial and technical assistance in developing infrastructure in Bangladesh. Now, Investors from Japan can come forward to directly invest in infrastructure development with their expertise. As a member of OECD countries, Japan is very much developed in the financial sector. BIMSTEC-Japan cooperation in financial sector may bring opportunities for Japan's investment in financial sector in Bangladesh that will help develop our financial and banking sector.

9. Concluding Remarks and Policy Implications

BIMSTEC-Japan cooperation may bring mutual benefits for both BIMSTEC countries and Japan. There is potential for cooperation in trade in goods and service, investment and other areas. However, the

potential gain is neither symmetric nor guaranteed for all member countries. Thailand may benefit from BIMSTEC-Japan cooperation that is evident from current level of bilateral trade and investment. India being a very large country also has scope for gainful cooperation with Japan. Although Bangladesh is an LDC and much smaller in size compared to India, still it has enough potential to gain from BIMSTEC-Japan cooperation because of the fact that Japan is a major trading partner as well as a major development partner of Bangladesh. In all these cases BIMSTEC-Japan cooperation can bring benefits to Japan as well. However, appropriate policies and actions are needed to reap the potential benefits out of BIMSTEC-Japan cooperation.

Effect of trade liberalization within a framework of RTA increases trade volume of the member countries. Extent of trade expansion depends on initial volume of trade, price elasticity of export and import and the extent of reduction in tariff and non-tariff barriers. Trade liberalization within an RTA is supposed to increase both export and import from the existing level, and accordingly bilateral trade balance (deficit or surplus) usually increases in the existing direction. Hence, BIMSTEC-Japan trade cooperation is supposed to increase Bangladesh's trade deficit further, as shown in the gravity model based simulation exercise. Hence, in addition to trade liberalization between BIMSTEC and Japan, steps must be taken to enhance export from the LDCs including Bangladesh to Japan. Non-tariff barriers (NTB) for exports from LDCs must be eliminated. Trade facilitation measures such as harmonization and simplification of trade rules and regulation, standardization of products, simplification of rules of origin may also be helpful for expansion of trade, particularly export from LDCs.

Japan as a developed country may provide duty free access either in terms of WTO principle or in terms of BIMSTEC-Japan cooperation framework. Some of the developed countries now-a-days allow very easy rules of origin (ROO) requirement for LDCs for duty free access to their market. Japan should also offer similar relaxed rules of origin criteria for duty free access of the products exported from Bangladesh and other LDCS within the BIMSTEC group.

As mentioned above, export of skilled and unskilled manpower from Bangladesh to Japan is crucially important for Bangladesh. The Framework Agreement of BIMSTEC provides for entering into negotiations to progressively liberalize trade in services with substantial sectoral coverage with a positive list approach with a view to progressively eliminating all substantial discrimination between and among the parties. However, for manpower export to Japan new principle may be set with special preference to labor surplus LDCs. Bangladesh (and other LDCs) of BIMSTEC group may negotiate the issue of manpower export with Japan under the umbrella of BIMSTEC-Japan cooperation. Emphasis may be provided on temporary movement of natural persons rather than permanent ones.

Existing trade deficit of Bangladesh with Japan which may enhance further by further trade liberalization within BIMSTEC-Japan FTA framework, establish the fact that mere trade liberalization in BIMSTEC-Japan cooperation may not bring much benefit for Bangladesh, rather it may create trade diversion and reduce welfare. Hence, cooperation must be extended to investment as well so that Bangladesh can develop export oriented or import substituting industries. FTA arrangement within the BIMSTEC region, however, may create an enabling environment for investment by offering a larger market size. Japanese investors may take advantages of the facilities by the EPZ to invest in export oriented industries.

Bangladesh has liberalized its investment regime to a large extent. It provides protection and many incentives to foreign investors. It ranks quite well in terms of ease of doing business index. JETRO report on investment environment in Dhaka is not discouraging either. Hence Japanese investor should come forward to invest in Bangladesh under the banner of BIMSTEC-Japan cooperation. Fields of investment needs to be identified through mutual visits of delegates and further study. Areas of joint venture, outsourcing, and industrial restructuring need to be identified and at some point, establishment of Japanese investment zone may also be considered.

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