ECONOMIC POLICY PAPER
ON
Relaxation of Controls on Foreign Exchange

SECTION 1

Rationale for Relaxation of Control

Exchange control, as we know today, is a product of Second World War. The belligerent nations sought to conserve critical resources through various forms of control, quota, rationing and expropriation of enemy assets to lend strength to their war efforts. It was these exigencies of the Second World War to which exchange control in Pakistan, and later Bangladesh, owe its origin. The war ended but it left deep scars on the warring nations, especially in Europe. They continued to maintain controls well into the fifties to revamp their shattered economies. The ripples of the great waves from principal theatres of war reached even the colonial India. In March 1947, the parliament of the then British India enacted the Foreign Exchange Regulation Act, 1947 incorporating the regulations and restrictions issued during the war.

Another reason for the perpetuation of exchange control arose from the need to maintain exchange rate stability. It should be recalled that the IMF, in quest of exchange rate stability, sought to revert to a watered down version of gold standard through introduction of what was known as par value system. Under this new system, US dollar was chosen as its main anchor, which, as the later events unfolded, collapsed under the pressure of its own weight.

The necessity to maintain exchange rate stability under the IMF system forced many countries to pursue a painful process of adjustment of domestic monetary and fiscal policies, in addition to strict exchange control, to ease pressure on their currencies. Thus, instead of exchange rates adjusting themselves in response to the economic fundamentals, the member countries themselves adjusted their economic polices in pursuit of exchange rate stability, often at the cost of employment and productivity. As the later events proved, this idea of par value conceived by some of the great economists on both sides of the Atlantic failed to meet the challenges presented by realities of the new world order. Economists across the world have now learnt to put their faith on flexible exchange rates as a key to accelerating world trade and collective welfare of the nations.

It was at the initial stages of IMF's experiment with par value concept that Pakistan was born in 1947. As a new member, Pakistan also undertook the responsibility of maintaining the par value of Rupee, its national currency, in terms of gold/ US dollar, via pound sterling to which it was then pegged. With a small export base dominated by two primary produces--jute and cotton-- and heavy dependence on imports the efforts to conserve foreign exchange reserve, reduce balance of payments deficits and to defend the par value of Rupee involved massive interventions to regulate foreign exchange payments.

SECTION 1
Rationale for Relaxation of Control

The history of erstwhile Pakistan's exchange rate management was one of its constant endeavours to maintain an over valued Rupee through strict rationing of foreign exchange resources. By the time Bangladesh parted company with Pakistan in 1971, the Rupee, which had an offic ial par value of Rs 13.43 against pound sterling, was overvalued by 6o to 80% as represented by free market rate. The level of overvaluation was as high as 200% if one takes into account the price of bonus vouchers, a proxy for foreign exchange entitlement, against which the importers could apply for Import License. In addition to the cost of foreign exchange they were required to pay another 25 to 30 Rupees to acquire the entitlement in the form of Bonus Vouchers. It meant an effective exchange rate of over Rs 40 against the official rate of 13.43.

Most people did and still do not realize that an overvalued currency was part of the strategy of Pakistan's rulers, drawn chiefly from the bourgeois class, to create a new elite group at the expense of the producers of primary commodities, most notably raw jute and raw cotton

Pakistan's preference for maintaining an over-valued rupee at the dictate of the elite group manifested itself in 1949, when Britain, along with other Sterling Area countries including India opted for collective devaluation in terms of gold/ US dollar Pakistan refused to follow suit. The results were disastrous. Its competitive strength dissipated in the world market and the trade with India, then one of its major trade partners, came to a stand still on account of its refusal to accept the over valued Pakistan rupee .It was a fortuitous event, namely Korean war, which generated heavy demand for jute bags to prepare bunkers, that saved the country from slipping into an abyss. Curiously, not realizing the implications of an over valued currency, people of erstwhile Pakistan, as always they were, took a certain amount of pride in having a currency stronger than their archenemy. Amidst this euphoria there began to emerge the legendary 22 familie s who later controlled the destiny of the nation in collaboration with the powerful bureaucracy and military generals.

What did an overvalued rupee meant in terms of distribution and redistribution of national wealth? The lower cost of foreign exchange pr ovided an opportunity for the elite core of industrialists to import machinery at cheaper costs. To make their task of wealth accumulation easier the rates of duty and tariff for these items were maintained at a very low level. Simultaneously, the governme nt also raised a tariff wall to insulate the so-called import substitute industries from foreign competition under the pretext of infant industry. These 'infants' never learnt to grow strong enough to stand on their feet but eventually became heavy burdens on the economy and the exchequer.

SECTION 1
Rationale for Relaxation of Control

The overvalued currency also meant that the growers of jute and cotton did not get the real value of their produces commensurate with the international price level. They were *ipso facto* forced to sell their produces to the jute and cotton mills at artificially depressed prices.

What about the elite industrialists who produced for the export markets? The over valued rupee obviously was not attractive enough for export. So a scheme was conceived to provide subsidies on manufactured products in the form of Bonus Vouchers.

In short, the multiplicity of exchange rates paved the way for economic polarization between the two wings and deprivation of the common people of both the wings. The seeds were effectively laid for the disintegration of the country.

After the liberation, Bangladesh quickly demolished the multiple currency structure through abolition of Bonus Scheme and re-fixing the exchange rate close to its shadow rate. Since the eighties, and more particularly in the nineties, Bangladesh has rightly chosen the path of dismantling the cobweb of controls but patches of old attitudes can still be seen permeating into the international payments system. The old spirit of control is still present and pervades the regulations. In maintaining controls, the authorities have, perhaps in the back of their mind, a long held belief that every one in Bangladesh wants to send money out of the country and this is something that they would not like to happen. This fear leads to the very intrusive set of regulations that seriously impede economic activities. In the meantime, around the regulatory walls there has grown a deep mistrust against all government regulations and various methods and systems to evade the rules.

What is important at this stage is to initiate another round of changes to ease the residual controls to prepare the road map for Bangladesh's entry into the freer trade regime-- a global village under the World Trade Organization (WTO).

Exchange Rates

The exchange rate policy in Bangladesh has witnessed significant transformation from one of rigidity in the seventies and much of eighties to greater flexibility in the nineties. Before the unification of exchange rates on January 01, 1992, Bangladesh effectively maintained dual exchange rates arising from operation of what was known as Wage Earners' Scheme. For some years now Bangladesh is, at least on theory, following a Real Effective Exchange Rate (REER) rule with a trade-weighted basket of currencies of the country's 15 important trade partners. The rule draws on the concept of purchasing power parity and seeks to maintain the exchange rates of Taka at the equilibrium level through periodical adjustments. The bottom line of these exercises is adjustment of the exchange rates of Taka to neutralize the effects of changes that take place over time in the rates of inflation and nominal exchange rates of the currencies of the trade partners vis-à-vis those of Bangladesh. However, in real life the signals from these exercises are by and large ignored. Because, they do not always conform to the perception of the authorities in Bangladesh as well as of the donors who are known to set a predetermined target for exchange rate adjustment. One-way movement of Taka is evident from the fact that its adjustment always involves depreciation regardless of the signals emanating from REER. There appears to have never been any occasion during the last two decades when exchange rates of Taka have been adjusted upward. It points to the inherent weaknesses in this system of REER and these weaknesses need to be corrected.

The options available are either abandonment of the REER or reconstruction of another formula that will hopefully address the realities of Bangladesh. But we must first look into the question about the equilibrium level for Taka. .

Need for Realignment

It is widely believed that Taka is still overvalued and is responsible for sluggish export performance and continued deficits in the balance of payments. Government, however, seems hesitant to depreciate the currency to the level warranted by the economic fundamentals. One reason is inadequate awareness regarding the roles exchange rates can play to influence productivity, growth and distribution of wealth. Another is political embarrassment that follows a major depreciation of currency. It is interesting to note that advanced countries, for instance Japan starts worrying when their currency Yen starts appreciating. United States displayed what was known as 'benign neglect' in the seventies and eighties to stem the erosion of the value of dollar. Although a depreciated currency lends competitive strength to the exporters in the world market, the political leaders in Bangladesh and, for that matter, in the underdeveloped countries are quick to demonstrate devaluation as a sign of weakness of the Government's economic policies.

SECTION 2
Exchange Rates

There is more in the exchange rates than meets a casual eye. Among other things, proper realignment of currency at a realistic level not only helps promotion of exports but also protects the domestic industries from the undue competition of imported goods. For Bangladesh, an additional factor is the need for protection of small and cottage industries including agricultural sector from the avalanche of smuggled goods from across the country's porous borders. While no reliable statistics are available on the volume of merchandise smuggled from across the borders the statistics on official trade with the country's big neighbor India shows that over the last decade the balance of trade have swung heavily against Bangladesh.

Table - 1
Trade between Bangladesh and India
(US $. in million)

A Year	B Exports from Bangladesh to India	C Exports from India to Bangladesh	D 'B' as % of 'C'
1987-88	8.87	87.32	10.16
1988-89	9.02	103.58	8.70
1989-90	20.05	148.08	13.54
1990-91	24.22	180.66	13.41
1991-92	7.65	231.33	3.31
1992-93	7.56	341.98	5.16
1993-94	21.37	414.49	5.16
1994-95	28.61	688.52	4.15
1995-96	24.44	1100.14	2.22
1996-97	28.01	921.74	3.04
1997-98	49.92	933.84	5.35
1998-99	60.00	1174.82	4.86

Source: Export Receipts 1996-97, 1997-98, Import payments 1996-97 & 1997-98, BB
(Note: Taka converted at the average exchange rate of the year as shown in BB Annual Report 1998-99.)

SECTION 2
Exchange Rates

While other macro-economic factors have contributed to the acceleration of Bangladesh's trade deficits an appreciated Taka in relation to Indian Rupee played no small part to exacerbate the lopsided trend. In fact, Bangladesh Taka has been kept firm not only against India but also against other competitors in the sub-continent Pakistan and Sri Lanka. Table 03 illustrates the point.

Table - 2

Comparative Changes in the Exchange Rates in the South Asian Region against US dollar (Period Averages)

Year	Bangladesh	India	Pakistan	Sri Lanka
1990	34.569	17.504	21.707	40.063
1991	36.596	22.742	23.801	41.372
1992	38.951	25.918	25.083	43.830
1993	39.567	30.493	28.107	48.322
1994	40.212	31.374	30.567	49.415
1995	40.278	32.427	31.643	51.252
1996	41.794	35.433	36.079	55.271
1997	43.892	36.313	41.071	58.995
1998	46.906	41.259	45.025	64.593
1999	51.050	43.615	51380	73.161
Depreciation				
--Between 1990 to 1995	14.42%	46.06%	31.45%	22.00%
--Between 1995 to 1999	20.98%	25.65%	38.29%	29.74%

Source: International Financial Statistics, IMF for 1990 to 1998. & Internet

Although these changes in nominal rates do not capture the changes in the real effective rates, they point to gradual erosion of Bangladesh's competitive advantage in the world export market over the last one decade or so. Apart from India, there has taken place significant changes in the exchange rates of Taka in relation to those of the countries in South East Asia. Many of them also are our competitors in the world market. Simultaneously, cheaper costs of imports have undermined competitive strength of the local industries based on indigenous raw materials. In fact, Bangladesh's effort to build a diversified base for exports has not seen much success due partly to unrealistic exchange rate system that weighs heavily against exports and import substitute industries based on indigenous raw material. The business community as well as the policy makers are seen taking pride on performance of the garment sector. Without undermining its importance, particularly on employment, it must be pointed out that if we adjust the cost of raw material imported from abroad and other peripheral costs like bank charges, buying house fees and stock lot the net contribution of this sector would probably be no more than 15% of what is exported physically.

It would be certainly naïve to suggest that exchange rate alone is at root of the country's economic illness or that a change in the exchange rate policy will trigger a dramatic turn around. Financial discipline and other macro-economic policies are equally, if not more, important. Never the less it can certainly play a major role in shaping the way Bangladesh will be able to conduct its foreign trade in the coming days.

It hardly needs explaining in greater details that exchange rate of Taka is not correctly aligned. The evidences are overwhelming: Bangladesh market is flooded with biscuits from Malaysia. fruit juice from Pakistan and *chanachur* from Bombay, not to speak of eggs from Tamil Nadu and *Rui* fish from West Bengal. In short, what we have is a paradise for consumerism sustained principally by remittances from Bangladeshi migrant workers abroad. Influx of imported materials has seriously undermined the country's big as well as small enterprises with adverse consequences on productivity and more particularly on employment. While consumerism flourishes, millions of unemployed youths are turning into potential threat to peace and stability.

Possible Options

These discussions are intended to highlight the need for adoption of more aggressive policy for management of exchange rates. The possible options are:

- Revision of the REER formula

Bangladesh may revise the REER formula to reflect the realities of Bangladesh's foreign trade including unofficial trade across the country's porous borders. Evidently, Real Exchange Rate Rules followed by Bangladesh to monitor exchange rates are inadequate to address the problem of finding an appropriate level. Among other things, in assigning the weights full weights have been given to exports and imports relating to readymade garment exports. It would have been logical to take into account only about 25% of RMG exports

SECTION 2
Exchange Rates

because only about this portion of exports is converted into Taka. The remaining 75% of exports and the entire amount of the imports by this sector can be left out of the reckoning because they cancel each other through the operation of back-to-back . In other words, exchange rate of Taka does not have relevance to the import of inputs by RMG sector since import cost is paid directly out of foreign exchange earned by export of final products under the bonded system. Another is import under foreign aid. It can be left out of the REER calculation because option to import under foreign aid, especially those tied for procurement from the donor country, does not normally depend on exchange rates but on the government's perception and willingness to accept the terms and conditions imposed by the donors.

The revised initial rate under the proposed formula may, if necessary, be established at a level that should restore the competitive strength of Bangladesh's exports and serve as a deterrent to the avalanche of foreign goods into the country through formal and informal routes.

- Major Depreciation of Taka

A major depreciation, like Thailand did a few years back, may be made to restore the competitive strength of Bangladesh in the world market as well as to reduce avalanche of imported goods. Thereafter this rate may be held at that level for a number of years.

- Floatation of Taka

Taka may be floated to find its own level. In the initial stages the central bank may intervene in the market to iron out fluctuations arising from short term or seasonal factors

At this moment clean float would probably be the best. In one stroke it will take care of imperfections associated with human judgement and avoid the need for maintaining elaborate controls on international payments. It will also eliminate one of the root causes of currency racketeering and encourage use of official channel for transfer of money from abroad to Bangladesh through official channel. At the same time the menace of money laundering that has seriously engaged the attention of the authorities will be greatly reduced.

SECTION 2
Exchange Rates

Long Term Forward rate

One of the major factors responsible for reluctance of foreign investors to invest money in Bangladesh is uncertainty associated with movement of exchange rates and absence of facility to cover the risks. The local investors in Bangladesh also remain under constant fear of depreciation of Taka, which inflate their costs of servicing debts incurred in foreign currencies by way of supplier or similar types of credits. Bangladesh Bank or the government has neither introduced any arrangement to cover these risks nor allowed the commercial banks to develop their own products. Under the free regime Bangladesh Bank may allow the banks to develop necessary products to protect the investors from exchange rate fluctuations.

SECTION 3

Controls on Imports

- The Ministry Of Commerce controls the physical aspects of imports into Bangladesh while payment aspects are controlled by the Bangladesh Bank.
- No person in Bangladesh can import goods into the country unless he is registered with the Chief Controller of Imports & exports (CCI&E) or exempted from the registration requirement.
- The banks, before opening a , must ensure that they deal only with known customers having a place of business in Bangladesh.
- Imports can be made only against Letter of Credit Authorization Form (LCAF) issued by an authorized dealer in foreign exchange i.e. banking institution authorized by Bangladesh Bank to deal in foreign exchange.
- LCAF is required to be registered with Bangladesh Bank if the AD intends to buy foreign exchange from Bangladesh Bank.
- LCAF ordinarily remains valid for remittance of foreign exchange for one year but for import of capital machinery and spares remain valid for 18 months subsequent to the date of issue or registration.
- LCAF can normally be utilized on C&F basis i.e. freight charges payable on an import should also be accommodated within the value of the LCAF.
- Imports into Bangladesh is generally subject to opening of documentary Letters of Credit with provision for payment against full sets of documents including a certificate of origin.
- LC can be opened against firm orders/ contracts.
- All applications for payments for imports should be made in a prescribed form known as IMP Form.
- The importers must submit within 4 months from the date of remittance relevant exchange control copy of bill of entry as proof of import.
- Certain imports can be made on deferred payment basis. These are capital machinery, coastal vessels, oil tankers and ocean going vessels up to 360 days; industrial raw materials for own use and agricultural implements and chemical fertilizer up to 180 days; life saving drugs up to 90days.
- LC may be opened on 180 days deferred payment basis for import of inputs by export oriented industrial units operating under the bonded system against Letters of Credit received from abroad for export of apparels and a few other items. Payments for these imports are required to be made out of export proceeds.

Suggested Areas for Relaxation of Controls

- Letters of Credit Authorization Form (LCAF)

Ordinarily, imports onto Bangladesh are subject to LC Authorization Form. Authorized dealers in foreign exchange (ADs) issue these forms. LCAFs are proxies for Import Licenses, which used to be issued directly by the CCI&E up to the seventies. The ADs issue the LCAFs on behalf of the Government in conformity with the Import Policy Order now being issued at the interval of 5 years.

LCAFs normally do not require registration with Bangladesh Bank. It is pertinent to mention that that before the liberalization of imports Ministry of Finance used to make allocations through annual Foreign Exchange budgets for various categories of imports including imports by the private sector. The responsibility for monitoring these allocations was entrusted to Bangladesh Bank through a system of registration of every Import License. Covering imports by the private sector against payment from the country's own foreign exchange resources. Since the system of allocations has practically been discontinued there is no practical utility for registration of LCAFs. For statistical purpose the central bank may collect information direct from the bank on periodical basis.

In short, the system of registration of LCAFs when foreign exchange is bought from the BB appears to be neither necessary nor logical. It seems unnecessary to draw a distinction between foreign exchange held by Bangladesh Bank and that held by the commercial bans. Both are the properties of the country. This requirement, which has become an unnecessary appendage to the import procedure and a source of confusions, may be dispensed with.

- Compulsory Opening of Letters of Credit

According to Exchange Control Regulations, excepting a few categories of imports, no import into Bangladesh can be made without opening a (LC). A similar provision also exists in the Import Policy Order (1997-2002)

This requirement for opening LCs was introduced in the erstwhile Pakistan after the 1965 Indo-Pak war when the country's foreign exchange reserve had nearly dried up and the government wanted to maintain a firmer control over imports. The situation has changed but true to sticky habits of the restrictive practices it routinely continues to remain a part of the system. The business community has become so accustomed to it that they have come to accept LC as an inalienable part of the system. As per the normal international trade practices the question of opening Letters of Credit depends on the buyers and sellers. This restriction has outlived whatever utility it had, more so in the current deregulated environment.

It is recommended that this requirement may be waived and the question of opening LC may be left to the discretion of the importers. It goes without saying that the buyers and sellers, on the basis of their business relations, select the mode of payment. When there exists long standing mutually satisfactory relation the parties may agree to exchange the merchandise without a . In that case they can save the costs involved in opening, advising, confirming and negotiating the LCs. If the option is given to the importers in Bangladesh the benefits, at least part of these benefits, of reduced import costs will undoubtedly percolate to the consumers. At the same time the country will save enormous amount of foreign exchange paid to foreign banks on account of opening of advising, confirming, negotiating and reimbursing the LCs. Assuming that 25% of Bangladesh's annual imports amounting to $8 billion can be procured without LC the estimated savings on this account would be in the region of one half of one percent. It means a national savings of the order of $10 million or about Tk. 500 million.

- Import on FOB Basis

According to Bangladesh Bank's regulations LCAF can be utilized on C&F (CFR) basis only. That means in addition to the FOB cost of the merchandise, freight cost for transportation by sea, air or land should be adjusted against the amount of the LC. In case, however, imports are made on FOB basis, the freight charges are to be adjusted against the LCAF value. This restriction can be traced to the days of strict exchange and import controls when there were quantitative as well as qualitative restrictions on all imports. The scarcity value of imported merchandise meant that one could make enormous amount of profits by utilizing the full amount of LCAF on FOB basis. On the other hand, FOB imports involve collection of freight, which in turn involves remittance of foreign exchange by the shipping company. It was for this reason that this requirement was imposed to keep the expenditure on imports within the budgetary allocation for import.

In the present context of liberalized Import Policy under which there is practically no quantities restrictions, this requirement appears to be superfluous and may better be dispensed with.

SECTION 3
Controls on Imports

- Submission of Proof of Imports

According to Bangladesh Bank's regulations importers are required to submit proofs that the goods for which remittance is made from Bangladesh are physically imported into the country. If the import is made by sea route the documents required to be submitted is called Bill of Entry. For shipment by post the required document is Custom's Certified Invoice and by air, Airway Bill.

This requirement was introduced in the early fifties by the then State Bank of Pakistan. The underlying objective was to prevent ‘false importing’ i.e. pretending to import so as to transfer funds out of the country. At that time there were only a few importers and the central bank could easily monitor import payments and their corresponding shipments. With the phenomenal increase of the number of importers it has become impossible for the central bank to keep a tab on an eye on the vast number of imports taking place in the country. Being unable to manage this task Bangladesh Bank has passed on the job to the banks. But the banks themselves are equally handicapped to perform this task, which does not feature prominently in their list of priorities. Sometimes the importers, especially those newly entering the import business, are unaware of this requirement and often the documents are lost. It is not easy for the banks to educate or pursue the vast number of defaulting parties. On the other hand innocent importers are taken to task under the Foreign Exchange Regulation Act, 1947 by Bangladesh Bank and law enforcing agencies long after the imports when it becomes difficult to produce duplicate copies.

It is what can be called a truly zero sum exercise and carries no significance for administration of exchange control in Bangladesh. But it hangs over the heads of the importers as Damocles’ sword. In the deregulated environment when the exchange rates of Taka are sought to be maintained close to kerb market rates there is not much that one can gain by sending foreign exchange in the garb of imports especially when one adds the cost of LCs, loss of interest on deposit of margins etc. This archaic piece of regulation may, therefore, be either dropped or replaced with one compatible with modern technology. Instead of what this requirement Bangladesh Bank may collect from banks and maintain a database on import payments. It can similarly collect from Customs information on actual imports. These two sets of data can be matched to collect whatever information the authorities want easily and quickly.

- Back-to-back Letter of Credit

Although foreign exchange is provided for all kinds of imports into the country on cash payment, export oriented ready-made garment (RMG) industry operating under bonded warehouse system are required to procure their raw material on credit or deferred payment basis from overseas suppliers. For this purpose the bank is allowed to open (LC) on back-to-back basis i.e. on the strength of a received by the industry from an overseas buyer. The back-to-back LC covers import of inputs subject to observance of domestic value added requirement. Payment against this LC is made with foreign exchange earned from export of the goods manufactured with these imported inputs.

The system was introduced in the early eighties when the foreign exchange reserve had dipped to critically low level and there was no provision in the Import Policy to allocate foreign exchange for import of inputs for processing and re-export. The authorities also did not foresee that RMG would assume the kind of importance in the country's foreign trade as it indeed did within a short time. The arrangement for import of inputs was made as an ad hoc measure. Since then RMG sector has blossomed into the level beyond the wildest imagination of those who had initiated the process of back-to-back . Although the reserve position later improved and even crossed the 3 billion dollar mark the system continued as a matter of routine perhaps to prove once again that old habits die hard. It is, however noted that with assistance from the World Bank an Export Development Fund has been created to finance direct purchase. However, it represents a very small share of total imports.

The restriction on import on cash payment basis has three important ramifications:

- The RMG units are required to incur considerable expenses on account of interest payable to the foreign suppliers to purchase the fabric and other accessories. It also involves loss of foreign exchange to the country because, on the average, the rate of interest payments to foreign suppliers is substantially higher than what Bangladesh Bank earns on investment of funds abroad.
- The restriction on import on credit terms narrows down the options of the RMG units to shop around in search of competitive prices. This is because many overseas suppliers are hesitant to send goods to Bangladesh on deferred payment basis especially on account of defaults of some importers to settle payments for merchandise imported on credit terms.
- Imports on deferred payments are more expensive in more senses than one. Among other things, the foreign banks as well as the local ones realize various charges such as confirmation, acceptance etc in addition to interest for the usance period.

SECTION 3
Controls on Imports

It hardly needs explaining that the system of back-to-back for financing input imports has become inadequate to meet the needs of the trade. In the context of WTO's upcoming new quota free regime it is important to replace the existing make shift arrangement with one that can hopefully enable our apparel industry to sustain the momentum that Bangladesh has been able to gain in this sector As explained above, the present arrangement is expensive and inconvenient. Additionally, the banking system is deprived of the opportunity to take part in financing these imports; foreign banks, by way of acceptance bills, take the business away from the local banks. The available options are:

- Import on Sight Basis

The dichotomy between ordinary imports and import of inputs runs counter to the government's declared policy of promoting and using export as the lynchpin for growth. All other kinds of imports, regardless of their contribution or importance in the national economy, are generously allowed foreign exchange facility for import on cash payment basis. Paradoxically, apparel industry, which is claimed as the major contributor to the country's foreign exchange earnings, is asked to fend for itself to finance import of their inputs. Bangladesh bank and the Government may work out a system to allow import of inputs on cash payment basis. It is assumed that even if this facility is allowed, many of the units will continue to import on credit terms. It means that the pressure on the foreign exchange would not be too high. In any case, if need be, the banks may be asked to raise finance from the international money market to meet the extra requirement. **It is worth pointing out here that commercial banks maintain foreign currency balance with their overseas correspondents on which they earn interest at the rate of LIBOR minus one or two percent. On the other hand, RMG exports pay LIBOR + 4% or even more. If the commercial banks are allowed finance imports on right basis by borrowing from abroad, they can do so at a much cheaper cost, say 2% above LIBOR. It will not only greatly reduce the cost of imports for the RMG units but will pave a huge amount of foreign exchange for the country. At the same point the banks will get an opportunity to gain an extra income through this intermediation.**

- Export Development Fund

Currently, there is an arrangement for financing import of inputs with foreign exchange borrowed from an Export Development Fund. This Fund was created initially with assistance from the International Development Fund and is administered by Bangladesh Bank. However the amount available in this fund is small and access is difficult and cumbersome. If the authorities are reluctant to allow import on cash basis like all other normal imports as suggested above, the size of this fund may be increased. The procedure is streamlined to allow easy access.

- Guarantee Fund

Presently the industry is allowed import of inputs only when they have an order in hand. Procurement of material on receipt of an order involves inevitable delays. On top of this, there are those inevitable *hartals*, non-availability of shipping space and work stoppages at the ports. All these add up to shipment failure and the consequent loss arising from the industry's most dreaded scourge, stock lots. There would be many cases where the garment units would know precisely the kind of materials they would need to execute upcoming export orders. They can remain well prepared to fill in these orders if a facility is given to import the materials in advance. For this purpose the government may create a Guarantee Fund for advance import under the bonded system.

- Import of Fabric and Yarn for e-commerce

E-commerce is quickly emerging as an important phenomenon in the not too distant future. The government may therefore institute a system under which selected units may be allowed to import fabric and yarn under the bonded arrangement. These can be used to fill orders received over the Internet system.

Regulation on Exports from Bangladesh

- With the exception of few items like bonafide trade samples, accompanied or unaccompanied personal effects, ship stores, transit cargo, gift packets of up to TK 20 and goods shipped under order from the Government, all exports from Bangladesh must be declared to the customs on a form known as EXP Form prescribed by Bangladesh Bank.
- Before submitting the EXP Form to the customs it must be certified by an AD with regard to arrangement made by the exporter for repatriation of export proceeds.
- Before certification the bank should ensure that the exporter is registered with the CCI&E.
- The carrier should ordinarily make out shipping documents relating to the exports, to the order of the certifying bank.
- Payments must be received through an AD in a freely convertible foreign exchange or in Taka from a non-resident account.
- Export proceeds should be repatriated to Bangladesh within 4 months from the date of export.
- Jute and jute goods may be exported on credit terms up to 360 days against irrevocable LC.

Retention Quota for Exporters

- Exporters are normally entitled to foreign exchange retention quota of 40% of repatriated fob value. However, for export of goods with high import contents, like POL products, ready-made garments, and electronic goods the quota is 7.5%. The quota for service exporters is 5%. Foreign exchange earned by agents cannot be put into retention account.
- The quota may be retained in FC account with ADs and can be used for bonafide business purpose like business travel, participation in seminar and fairs, maintenance of office abroad and import of raw materials, machinery and spares.

SECTION 4
Regulation on Exports from Bangladesh

Possible areas of Liberalization

The regulations concerning declarations and repatriation of export proceeds were framed in the late forties while the retention quota system symbolizes the liberal attitude of the mineties. The older one also reflects the anxiety of the authorities in the initial stages of the birth of Pakistan regarding the need to collect whatever amount could be earned by export from the country. Due to a big gap between the official and unofficial rates, the authorities apprehended that unless strictly controlled the exporters would not repatriate the export proceeds through official channel. Since the position has changed significantly, many countries have dispensed with the requirement of repatriation of export proceeds. If the exchange rate is kept at the right level there should no longer be any fear that exporters would not bring back the export proceeds. After all, export houses, like all other business enterprises, have commitments in the country and they cannot keep on accumulating money abroad just for fun. They have, inter alia, bank loans to repay and wages to pay to continue their business. In this situation, Bangladesh Bank may dispense with the elaborate formality of exports. It is recognized that exports lead to higher productivity, which again generate employment. Instead of worrying about what an exporter would do with his money abroad it would certainly be a big step forward the exports from the rigidities the export. Only a nominal check may be maintained at the customs level for realization of tax or duty, if any, and prevention of shipment of banned items. If the authorities do not feel comfortable to make the relaxation in one step, a beginning may be made by freeing export of all non-traditional items from the declaration and repatriation requirement. All items taken for sale abroad like carpets, flowers taken as accompanied personal baggage may also be exempt from the requirement of declaration and repatriation of export proceeds.

SECTION 5

Controls on Exports from Bangladesh

- Freight and Passage Collection: Bangladesh Bank has delegated authority to the ADs to make remittances of freight and passage collections by branches and agents of foreign airlines and shipping companies on the basis of necessary documents after adjustment of the costs incurred in the country.
- Operating Expenses of Bangladeshi Airlines and Shipping Companies: Bangladesh Bank has authorized the banks to make these remittances in genuine cases subject to submission of necessary returns to Bangladesh Bank for post audit..
- Export Claims: the banks are authorized to make remittance of export claims up to 10% of the repatriated export proceeds on accent of claims arising from short weight, quality, part shipment and other types of claims. BB has prescribed elaborate procedure and drills for this purpose.
- Employment of Overseas Agents: BB permission is required to employ the services of agents abroad.
- Branch and subsidiary Companies Abroad: BB permission is not required to open branches or subsidiary companies abroad but it has to be reported to them within one month. Remittance up to $30,000 may be made annually to meet current expenses of such offices on submission of required documents.
- Remittance of Royalty and Technical Assistance Fees: Banks are authorized to make remittance up to 6% of imported machinery for new projects. For ongoing projects, the limit is 6% of the previous year's sales as declared in the income tax returns. Remittance in excess of this amount requires specific approva l of the Board of Investment.
- Remittance of Profits: The foreign companies can transfer abroad through AD the profits earned by their branches including sterling tea estates in Bangladesh after making adequate provision for payment of taxes on submission of audited accounts. These remittances do not require BB permission but they have provided certain guidelines to the banks on how to work out the remittable profits.
- Remittance of Dividends: These remittances can also be sent abroad through the banks on the basis of the guidelines provided by the Bangladesh Bank.
- Subscription to Foreign Media: The ADs are authorized to make remittance abroad cost of news items, features etc. payable by local newspapers.
- Advertisement Abroad: The cost of advertisement of Bangladeshi products abroad may be sent through ADs on submission of necessary invoice and clippings of the relative advertisement.

SECTION 5
Regulation on Exports from Bangladesh

Suggested Changes

The present arrangement for remittance of foreign exchange on account of invisible payments is generally satisfactory. It does not pose any serious problems for the business community. However, the following areas need further attention to make the liberalization process more business friendly.

Export Claims

Currently remittance of export claims can be made up to 10% of exports through authorized dealers. BB permission is required if a higher amount of remittance is involved.

The export claims more often than not involve remittance at a higher rate. The formalities required to be observed for this remittance involves delays, which strain the relation with the foreign buyers. This restriction is a remnant of the pre-convertibility era of strict foreign exchange controls and does not fit into the liberalized atmosphere. The system may now be changed to allow the authorized dealers to make remittances on this account irrespective of the amount involved from the exporter's retention account. If the exporter does not have a retention account or if the balance in this account is insufficient the AD may make the remittances from the country's own resources subject and report this to Bangladesh Bank with periodical returns.

SECTION 6

Miscellaneous Controls

Investments Abroad

Under the present arrangement there is no provision for remittance of foreign exchange from Bangladesh for investment abroad. On the other hand, opportunities are available in many parts of the world to make investment through joint collaboration in areas where Bangladesh has achieved successes. One is ready-made garment and another is pharmaceutical production. Bangladesh has also earned a name in the ceramic industry. There is also a good prospect of setting up banks, exchange and finance houses in many countries of the world. In fact, Bangladesh has already made a breakthrough in this field through joint collaboration in Nepal, Myanmar, Oman, Kuwait, Qatar, etc.

In the absence of foreign exchange facility many Bangladeshi entrepreneurs have made investment abroad by acquiring foreign exchange in the black market. However, many corporate bodies including bank and financial institutions would not like to get into these types of clandestine arrangement. The opportunities to augment foreign exchange earnings and employment opportunities therefore remain unexplored.

Admittedly, Bangladesh has not yet opted for capital account convertibility. But special dispensation can be made on selective basis to provide opportunities for investment abroad by Bangladeshi firms. This will be consistent with the Government's outward looking economic policy.

Invisible Receipts

Many firms and individuals in Bangladesh work as agents of overseas suppliers. They are popularly known here as indenting agents. They receive commission from the suppliers against orders procured in Bangladesh. There are also lawyers, solicitors and charter accountants who receive remunerations from overseas principals. Writers and authors get money from foreign journals and publishers. Consultants also collect consultancy fees from agencies and business houses abroad. In short, Bangladesh earns a handsome amount of money through invisible sources, the most important one being remittances sent by overseas Bangladesh nationals. Bangladesh Bank cannot obviously monitor these remittances. Wage earners are absolutely beyond their control as the foreign exchange law cannot force them to repatriate their earnings to Bangladesh. Nevertheless they are sending a huge amount of about two billion dollar annually through official channels. Perhaps another two billion comes through the open market. Contrary to popular belief the money coming through the open market is not lost to the country. From a broader social welfare perspective they produce more or less same kind of benefits, as do the official remittances. Other people residing in Bangladesh and earning foreign exchange come within the mischief of law. But the long hand of law barely reaches them. Bangladesh Bank has introduced a system of registration of indenting agents and other kinds of recipients to monitor these remittances by calling for periodical returns. But this exercise becomes counterproductive and a source of corruption. Only a fraction of potential remittances comes through official channels. The results are the same with regard to other invisible remittances.

The efforts to capture the invisible remittances through registration with Bangladesh Bank was introduced in 1978 in the backdrop of serious foreign exchange crisis when there was also a wide margin between official and free market rates. Now that this gap has been substantially closed it seems unnecessary to pursue a policy that cannot be implemented. According to IMF annual survey most of the countries, especially those who have opted for convertibility of their currencies, have abandoned the requirement of compulsory repatriation of invisible earnings. A similar step may be taken in Bangladesh also to save business community from the hassles and expenses--visible as well as invisible– that go with registration and submission of returns.

Information Technology Industry

IT Industry is facing handicaps to make purchases over the Internet. One needs a credit card to make these purchases but the credit cards in Bangladesh are normally available for domestic transactions. For these reasons many are forced to maintain illegal accounts abroad. To introduce transparency in this respect necessary arrangement may be made to allow necessary foreign exchange facility to the authorized companies, perhaps through introduction of debit cards.

Hundi Market

Hundi market, the local description of currency racketeering, has lately become a subject of serious discussions. The central bank is also seen to be taking strong action against banks that are allegedly allowing use of bank accounts for settlement of hundi related transactions. In view of the implications of hundi business on the economy some comments on this subject will be relevant in the broader context of this study.

SECTION 6
Miscellaneous Controls

Hundi is not an end by itself but a means as well as symptom that inevitably show up in every country where exchange control is practiced. It feeds on demands for foreign exchange for which access to official channel is either prohibited or limited. These demands arise chiefly from (a) the need to finance smuggling, (b) under-invoicing of imports to reduce the incidence of duties and taxes, (c) to transfer wealth, (d) to meet expenses for treatment and education abroad (official allocation are either inadequate or access is difficult), and (e) for investment in business or real estate.

As long as official allocations are not available, there would always be people willing to pay higher than official price of foreign exchange. The supplies come mostly from ove rseas Bangladesh nationals many of whom succumb to the lure of higher price of their hard earned money.

The answer to eliminating the menace of kerb market of foreign exchange lays not so much in setting the police to catch the culprits but in eliminating the root causes that underlie these transactions. Deployment of law enforcement agencies, especially when the existing level of honesty is taken into account, will be counterproductive. The raids on the bank accounts are also likely to meet the same fate. On the other hand, these types of actions may drive the money to the underground and undermine the liquidity in the banking system.

Instead of focusing attention on people engaged in hundi, emphasis should instead be shifted to the real issues i.e. the factors that contribute to these transactions. Hundi cannot be eliminated, but one way of reducing it would be to improve the banking arrangement for collection and disbursement of migrants' remittances. In the final analysis, however, clandestine foreign exchange business can be wiped out by further liberalization of exchange and trade controls.

SECTION 7

Capital Account Convertibility

The question of whether Bangladesh should go for full convertibility is being debated since Bangladesh took the bold step of declaring Taka as convertible for current account transactions. Contrary to what many feared, that step did not pose any serious threat to the foreign exchange reserve or balance of payments. On the contrary, excepting the temporary brake put in by the 1998 flood, the country has witnessed a steady improvement of the GDP and relative stability in balance of payments and foreign exchange reserve.

One could easily visualize that there would inevitably be a nagging fear of foreign exchange outflow if the country opts for capital account convertibility. **This fear is perhaps justified but there is very little that the authorities can do to stop the outflow.** After all people with money — black or white — can and indeed do transfer money with relative ease through a well-organized network of currency operators. These transfers take place for a host of purposes — investment in business, purchase of real estate or simply to park money away from the prying eyes of the authorities. This system is so deep rooted that no one can wish it away.

In short, though Taka is not convertible for capital account there is no effective means of stopping the outflow. These transactions and the **non-satiated** demands for foreign exchange feed the hundi market and drive a good chunk of the foreign exchange business to the clandestine channel. Theoretically, freeing the market from the restrictions on capital types of transactions will introduce transparency in foreign exchange transactions and eliminate overnight the role of the currency operators. **However, before embarking on the program of capital account convertibility, it would be necessary to put in place sound monetary and fiscal policies and financial discipline to avoid the sudden turbulence of the kind that rocked the country's stock market in 1996 in the wake of current account convertibility.**

SECTION 8

Recommendations

In the light of the above discussion following are the recommendations with a view to creating favourable environment for the businesses of the country relating:

1. Exchange Rate

- Exchange rate of Bangladesh currency, Taka, may either be revised to reflect its intrinsic worth. **REER formula may be revised to capture the pattern and composition of Bangladesh's import trade. The best option appears to be flotation of the currency to avoid the imperfections associated with human judgement.**

2. L/C Regulation

- LC authorization form need not be required to be registered with Bangladesh Bank even if foreign exchange is intended to be bought from that bank.
- Opening of LC for imports into Bangladesh may be made optional.

3. Liberalisation of Import and Export Business

- Current practice of submission of proof of imports (Bill of Entry etc) may be replaced by a pragmatic system based on computer generated data.
- Export oriented RMG unit may be allowed the option to import inputs on right (cash) basis.
- Allow import of yarn & fabric on bonded system to fill in orders under e-commerce.

4. Remittance of Export Business

- Allow the authorized banks to approve remittance of all export claims.

5. Easing Bangladeshi Investment Abroad

- Special allocation may be made for investment abroad in areas where Bangladesh has developed expertise e.g. RMG, jute industry, ceramic, pharmaceuticals, banks & financial institutions

SECTION 8
Recommendations

6. Easing Business Transaction

- Invisible receipt like indenting commission, consultancy fees etc may be exempt from the requirement of repatriation as it is not practicable to monitor these payments.
- IT indenting may be given foreign exchange allocation to make purchases over the Internet.

7. Elimination of Hundi Market

- Improving the banking arrangement for collection and disbursement of migrants' remittances; freeing the market from the restrictions on capital type of transaction.

8. Capital Account Convertibility

- **Bangladesh may put in place sound monetary, fiscal and other macroeconomic policies and practise financial discipline to pave the way for capital account convertibility.**