

Budget 2013: No winds of change in trade policy

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While newspapers are awash with copious amounts of reporting on

budget reactions, scant attention seems to have been paid to one critical dimension of economic policy in the budget — trade policy. Most reports seemed to ignore the fact that a substantial portion of trade policy for the coming year was being formulated under this budget. Indeed, in the latest scheme of things, while multilateral and regional trade and preferential trading arrangements are the responsibility of the Ministry of Commerce, much of the trade policy instruments that affect incentives to domestic production and exports lies with the National Board of Revenue (NBR), i.e. customs administration. Trade taxes, though declining as a share of tax revenue, still make up 40% of NBR taxes. But, in the process of formulating and implementing these taxes, through budget pronouncements, profitability of import substitute production on the one hand and export competitiveness on the other are impacted with serious implications for trade as well as growth prospects.

The proposed budget for fiscal year (FY)13, therefore, is not just a macro-fiscal statement but a key trade policy directive with its announcement of adjustments in several trade taxes — customs duties, supplementary and regulatory duties — which in the trade nomenclature are termed as tariffs and para-tariffs. The business community understands more than anyone else that these changes will affect incentives and profitability in business and industry, and, in consequence, influence investment decisions.

A single message of trade policy that stands out in the budget statement is that the changes are done to assist local industries. Indeed, that might be so, at least for the time being. But just as a pampered child often becomes unfit to face the real world, industries propped up by high protection for too long are likely to face eventual decline as greater global competition is

unleashed in coming years. However, a quick review of the increase and decrease of customs duty (CD) and supplementary duty (SD) rates is likely to lead one to believe that the predominant objective this time perhaps was higher revenue mobilization than protection, though a clear judgment on this issue will have to wait a much detailed analysis of the plethora of SD increases that have been proposed. As one can see, substantial SD increases on several fruits will certainly undermine protection to the blossoming agro-based industries that produce fruit juice, jams and jellies, and export or cater to the domestic market.

It boggles my mind to see a host of readymade garment (RMG) items subject to SD increases. This sector, which is internationally competitive, surely is not crying for protection. Then what is the purpose of raising SD on several items of woven garments and knitwear? It seems assistance to local industries has been enhanced by reducing CD on a number of intermediate goods and basic raw materials used by domestic industries. Finally, Regulatory Duty (RD) of 5.0% on the top rate of 25% has been retained this year, ostensibly to raise protection to local industries. Thus, in general, one sees an increase in the tariffs on final goods (finished products) and some reduction in the rates on intermediate inputs and raw materials. The net result of this approach is an augmentation of existing protection to domestic industries as stated in the budget.

A first assessment indicates that average protective tariffs, which rose from 23% in 2009 to 26.5% in 2012, will move a notch higher were these proposed adjustments to become final. That would simply confirm the upward trend of tariffs and para-tariffs witnessed in the past three years, implying a continuation of the prevalent restrictiveness in the trade regime. These tariff trends — arguably to raise protection to domestic industries — are in contrast to the long-term trend of gradual tariff reduction over the past two decades, to keep in step with global trends.

As it is, tariff protection levels in Bangladesh have been described by analysts as high. Bangladesh regularly is being listed by multilateral observers as having a relatively restrictive trade regime. Continuation of this stance might prop up current profitability of import substituting firms. But import-substitute production catering to the domestic market cannot create jobs for the two million people added to the workforce each year. Export production can. Research based on history and global experience indicates that such protection for long periods is bound to create inefficiency and undermine export competitiveness in global

markets.

We need to reflect if this is the kind of trade regime that will yield the 7.0-8.0% gross domestic product (GDP) growth rate in the medium term, and 8.0-10.0% growth rate over the long-term, as envisaged in the Sixth Five Year Plan (2011-15) and the Perspective Plan (2010-21). International evidence shows that hitherto developing countries that grew at 7.0-8.0% rate for a decade were completely transformed from low-income to middle income countries; but their growth record was characterized by open trade regimes. If we do not achieve 7.0-8.0% growth over the next two to three years, the chances of achieving middle income status by 2021 might also be receding.

Can Bangladesh ignore the evidence and expect to achieve 7.0-8.0% sustainable growth in the medium-term while leaving the trade regime as it is while our comparators are doing things differently? It appears highly unlikely, even if we were to solve the power problem soon. Investment will continue to be stymied by a trade regime if it is not sufficiently open to welcome foreign direct investment (FDI) — the investors from abroad who look at Bangladesh as an attractive destination to locate production units but with export markets in mind.

Make no mistake. Our RMG sector is unaffected by such protection strategy — as they enjoy free trade channel with duty-free imports and back-to-back letters of credit (LC) provision — but other exports and potential exports lose incentive to explore markets abroad as profit margins at home are propped up by higher tariffs. This undermines the strategy of export diversification as well! Can Bangladesh attain high and inclusive growth riding on just one export product, no matter how promising garment exports appear in the future?

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