Budget FY09: Import substitutes win over exports

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Riding on the wave of a record revenue performance in FY08 (up nearly 24 percent), but fading business
confidence for the most part, Budget FY09 could afford to ease the tax burden on business and industry. So it
did. A preliminary assessment of the tax and tariff proposals finds a general scaling back of import taxes on raw
materials, machineries, and intermediate inputs, alongside protective increases of tariffs and para-tariffs on
finished goods of selected import-substitutes.
In the sphere of direct taxes, some relief is also evident in respect of corporate taxes, together with mitigating
measures for easing the tax burden on SMEs. Rather than eliminating tax holidays completely, there is a
proposal for a staggered elimination over the medium-term.
With regard to trade policy, in a departure from past trends, the budget is conspicuous by an absence of any
commitment to keep trade liberalization on track. Over the past year, the caretaker government has assessed the
trade-off between the trade policy goal of greater openness that introduces more import competition and the
need for raising profitability of business and industry in the backdrop of spiraling international prices of
industrial raw materials and intermediates and an adverse investment climate.
Budget FY09 comes out in favor of raising business profitability, ostensibly in line with pre-budget submissions

by various chambers.
Suffice it to say that FY08 has been a tough year for business and industry in Bangladesh, mainly due to rising
production costs. The tax and tariff measures in Budget FY09 will therefore help to ease the cost burden and
raise profitability of business and industry.
A nagging question that remains is whether there is any incentive in this package to promote productivity and
efficiency, or to foster competition. In the absence of such measures, the proposed tariff adjustments will raise
profitability without any benefit accruing to consumers, as prices are unlikely to fall since tariffs on outputs
have not been reduced. Nor is there any hint about raising export competitiveness. In general, the importsubstitute lobby seems to have won out. Profitability though not efficiency of producing for the domestic market
gets a boost.
The idea that a four-tier tariff slab has replaced the old three-tier tariff structure is a myth in the sense that the
FY08 structure was essentially a four-tier structure (i.e. 5, 10, 15, and 25), though the 5percent tariff for capital
machineries was maintained. This year, the same slab reduced to 3percent, has been formally announced.
Preliminary estimates suggest a reduction of average nominal protection compared to last year from 22 percent
to 20.4 percent. This decline roughly corresponds to the trend reduction in average tariffs over the past three
years. These adjustments will leave a dent in customs revenue to the tune of 10 percent (from its expected
growth) or roughly 0.3-0.4 percentage points of GDP. The sharp difference this time around is that almost all of
the reduction comes from slashing duties on intermediates and raw materials.
This should not lead to the conclusion that protection for import-substituting industries has been reduced. With
top rates, including supplementary duties largely in tact, the tariff reductions on basic raw

materials,
intermediates and capital machinery, leads to the logical inference that effective protection to domestic
industries has gone up.
Given the pronouncements of the Finance Adviser during the last budget regarding making protection timebound, and given his understanding of the efficiency costs of protection if sustained for long, these tariff
proposals are disappointing for those who counted on his commitment to continue to take trade openness one
step further.
A number of domestic import-substituting activities have been identified for higher effective protection and
occasionally complementing this with supplementary duties(e.g. paints and varnishes, Teflon tape, printed
books and brochures, children's coloring books, diamond (polished), table and kitchenware, electrical apparatus,
etc.). The underlying logic seems to be if an activity shows signs of success, give it more protection. The
analytical underpinnings of such a policy stance quite common in the past is debatable.
The one significant policy change, which will enhance competitiveness of exports, is the introduction of bonded
warehouse facility for enterprises that have 100percent export-oriented units. Like RMG, they can now import
inputs without having to pay duties. This should spur growth of non-RMG exports and propel export
diversification.
All in all, Budget FY09 signals little or no progress towards greater trade openness, which appears to have
become a victim of adverse economic circumstances in the past year. Meanwhile, a few rising industries
ostensibly doing well in the domestic market have a chance to augment their profits. Let us hope this gives them
the incentive to expand and create jobs. Yet, global evidence and Bangladesh experience suggest it is enterprises

geared to the export market that have the greatest job creating potential.