Calling for more trade policy focus in budgets

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VIEWS & OPINION

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Presenting a national Budget in the time of Covid-19 lockdowns and other limits to normal life must itself be a Herculean task. So the government and the Finance Minister, along with the teams that burnt the midnight oil at NBR and the Finance Division, deserve our gratitude for completing this constitutional obligation to the nation, on time. Technically speaking, all public expenditures for the coming year now have the endorsement of the people through parliament.

When it comes to the Budget there is so much to talk and write about. So at the outset let me stay focused on what could be a rather narrow but quick take on one particular aspect of the budget that is usually left unattended, by the budget itself as well as its vocalists around town. Trade policy comes to mind. It is one of the three major policy components of

macroeconomic management of the economy – fiscal policy, monetary policy, and trade policy. Yet it is the least talked about. Overall, Bangladeshis should be thankful to our policymakers who, for all their shortcomings that we are often quick to point out, have been prudent enough to ensure stability of the macro economy for over three decades, creating the right conditions and environment on which to build ambitious plans for the future. And all this happened in the face of heavy odds arising from natural and man-made calamities striking the economy and society, time and again. Covid-19 crisis is only one – albeit perhaps the severest – among many such episodes in Bangladesh's journey traversing half a century.

Covid-19 pandemic has delivered a health-cum-economic shock to the Bangladesh economy disrupting — hopefully temporarily – its onward journey towards becoming a Middle Income Country (MIC) by 2031, after graduating out of LDC status in 2024. To my mind, this disruption is unlikely to shift those two critical national milestones up ahead. FY21 Budget confirms that. In that case, we need to lay strong foundations for not only cushioning the shock from the Covid-19 pandemic but also to stimulate a robust and sustainable economic recovery. To this end, the Government's fiscal and monetary stimulus package along with FY2021 Budget should provide strong ammunition on the path to economic recovery. Initial estimates suggest the number of poor people (32 million or 20 per cent of the population) might have risen to 50 million, as many living above the poverty line fell into poverty having lost jobs and livelihoods. Given the enormity of the health-cum-economic crisis, in all likelihood more resources might be needed until the crisis is behind us.

For the time being, the monetary and fiscal package puts Tk. 1.1 trillion (3.5 per cent of GDP) on the table directed at four response areas: (a) expansion of social safety net programmes, (b) increased public expenditure, (c) providing fiscal stimulus to business, and (d) monetary easing to expand credit and promote investment. All of these are just what the doctor ordered. A closer look, however, reveals that much of the package goes to expand 'lending' rather than 'spending', and Bangladesh Bank will have to prod the commercial banks to lend more and fast. Hence the fiscal cost of the package is much lower, estimated at about $4.3 billion (about 1 per cent of GDP). The FY21 Budget of Tk. 5.7 trillion (18 per cent of FY2021 GDP) of planned public expenditure also adds additional resources within the allocation of various ministries to combat the crisis and fuel recovery. We should not be surprised if more fiscal resources become necessary to cope with the rapidly evolving crisis.

First and foremost, the FY21 Budget is a rendering of the government's fiscal stance or fiscal policy. A prudent fiscal deficit of 6 per cent of GDP is programmed for the year with expected revenue mobilisation of 12 per cent and expenditures of 18 per cent of FY21 GDP. The Covid-19 impact, which is a combination of supply and demand shock to the economy, has left FY20 revenues in shambles – actual revenue mobilisation until March 2020 was a meagre 6 per cent of GDP. Unless FY21 GDP itself underperforms significantly, 12 per cent revenue target will be a stretch by any imagination.

Nevertheless, fiscal policy for FY21 continues on a traditional expansionary path, though some economists would argue for the need of a larger budget deficit of 7per cent+ in these challenging times. The low public debt-GDP ratio of 35 per cent leaves wiggle room for some temporary surge in public spending, if that is to save lives and livelihoods. I have heard leading economists of the world say this is not the time to worry about "debt and deficits". As for external deficit financing of 2.5 per cent of GDP, provided that we do our homework diligently and undertake a few good policies, the prospects of adequate low-cost multilateral financing is quite good this year of Covid-19 global response. After all, a sluggish global economy is good for no one.

Monetary policy comes into play in financing the fiscal deficit, particularly the domestic financing part, which the Budget sets at 3.5 per cent of GDP (Tk.1.1 trillion). Inflation targeting, interest rates, credit growth, and money supply are all affected by the stance on domestic financing of the fiscal deficit. This is where fiscal and monetary interdependence comes into play. So much of monetary management stems from the fiscal deficit that it seems so far-fetched to talk of central bank autonomy in the Bangladesh context. Fiscal-monetary policy coordination is the sine qua non of our growth strategy as much as it is now an essential component of Covid-19 crisis management and economic recovery. Not just in Bangladesh, but around the world. Covid-19 pandemic has invoked a symbiotic relationship between monetary easing and fiscal stimulus policies like never before.

So where does trade policy belong in all of this. Global trade has been a major casualty of the global supply and demand shock of Covid-19 pandemic. While IMF projects global output to shrink by 3 per cent or more, the multilateral institution projects a steeper decline for global trade – at least a 5 per cent decline. All this could be revised downwards in IMF's next revision coming this July. That puts Bangladesh export prospects in 2020-21 in serious

jeopardy. But we remain optimistic counting on a V-shaped recovery in the world economy as well as our own. So the FY21 Budget stipulates exports to recover at 15 per cent growth, a jump from -10 per cent negative shock in FY20. This matches the highly optimistic GDP growth assumption of 8.2 per cent for FY21, though ADB has lately revised its own growth optimism downward to 7.5 per cent. The first impression one gets from the Budget is that monetary and fiscal policies together might do a good job of coping with the immediate Covid-19 impact but lacks the jet fuel needed to boost the economy from a Covid-19-induced coma to a rapid recovery of 8 per cent+ growth. This is particularly true in the absence of a trade policy stance of any magnitude. Here, one gets the impression from the Budget that if there is something called trade policy, it hardly matters.

But it is trade policy that links the global marketplace with our economy. Trade policy is the mechanism through which developing economies can leverage the vast global market for exports, job creation, and GDP growth. Leading growth experts of the world have concluded, in no uncertain terms, that the history of rapid growth performance of 7-8 per cent reveals that it is the strategy of leveraging global markets through export-oriented manufacturing that yields such high growth. History of Bangladesh economy tells us that our economy has been successfully doing just that. Domestic markets, because of their limited size, simply lack the scale economies needed for the kind of industrial expansion that creates millions of jobs and stimulates growth. Understandably, Covid-19 pandemic has put a damper to this line of economic reasoning but it cannot be the end of it. For all its shortcomings, globalisation is irreversible and Bangladesh is among the significant beneficiaries of the globalised world. We should continue to harness the positive gains from this global regime through greater not lesser trade integration even in the post-Covid-19 world. Adopting the open stance of trade policy is and will remain the right approach. While the Bangladesh economy has demonstrated its ability to grow at 7-8 per cent in recent years, historical and cross-country research tells us that such high rates can only be maintained by leveraging the vast global economy through greater trade integration. It would be nice if our Budgets acknowledge this theoretical principle that Nobel laureate economists and leading growth experts endorse.

This is where one finds that the FY21 Budget sets the trade goals right but the trade policy means appear lacking. Note also that this Budget launches the first year of the 8th Five Year Plan (2021-25) which is expected to build an ambitious programme of export-oriented industrialisation on the heels of good achievements made during the period of the 6th and

7th FYP. Recognising the vulnerability associated with export concentration in RMG, the Budget rightly emphasises export diversification as a priority goal, highlighting a long list of non-RMG products that will be receiving government support for their expansion. But apart from an occasional reference to reducing an input tariff or raising an output tariff, ostensibly to protect an industry, what is conspicuously missing is a concerted trade policy programme of setting the balance of incentives right. All of the non-RMG products cited (e.g., footwear, plastics, electronics, agro-processing, furniture etc) are import substitutes which are highly protected in the domestic market with the highest tariffs and para-tariffs, making their domestic sales far more lucrative than exports – classic case of anti-export bias. The biggest challenge in Bangladesh's trade policy is to rationalise protective tariffs strongly enough to at least make relative incentives between exports and domestic sales equally profitable. One would have hoped that that would be the objective of "tariff rationalisation" mentioned in the FY21 Budget but it turns out not to be.

Let me end with a few final remarks about our exchange rate stance – a pivotal component of trade policy. The system of fixed exchange rates has long been abandoned around the world shifting in favour of flexible exchange rates. Economies that have achieved export success have all shown one common trait – they strictly avoided overvaluation of their currencies and often chose to keep their exchange rates depreciated. Bangladesh floated its exchange rate in 2004. But, like most countries, it stuck to a regime of "managed float", where the Bangladesh Bank strictly monitors the movement of the exchange rate and intervenes, apparently to keep the nominal exchange rate from depreciating too much too fast (i.e., more Taka per US dollar). PRI research has shown, in many write ups, how that real effective exchange rate (REER) has significantly appreciated over the past five plus years undermining export competitiveness. Exporters suffered as they were not getting a decent taka value of their export sales. A 1 per cent cash incentive to RMG exporters and 2 per cent incentive for remitters is no match to, say, a 5-10 per cent depreciation of the exchange rate that has remained steady at Tk.84.5-85.0 since January 2019. It is important to note that 5-10 per cent depreciation of the exchange rate is equivalent to a 5-10 per cent cash subsidy to all exports and remittances, across the board, and the cash subsidy does not have to come out of the public exchequer. PRI research has also shown the way to counterbalance any inflationary effects of such a depreciation, by downward adjustment of tariffs without affecting customs revenues. As for the final argument that such depreciation will raise the cost of external debt financing, may I add that our external debt servicing rate is a mere 4

per cent of our foreign exchange earnings, which will not change, except that Taka fiscal cost may rise 5-10 per cent– a minor irritant for an economy whose low level of indebtedness has been recognised recently by The Economist (Bangladesh was ranked 9th among the least indebted countries of the world).

To conclude, the FY21 Budget of Tk.5.7 trillion combined with the government's monetary-fiscal stimulus package of Tk.1.1 trillion, as well as all the administrative mobilisation for addressing the Covid-19 pandemic emergency, are all timely and appropriate, and will go a long way in coping with this national emergency. It is the economic recovery part that might need more than what the budget has put on offer. As the global economy wakes up from the slumber of Covid-19, Bangladesh will need more robust trade policy and export orientation to make any headway in FY2021 and beyond. Otherwise, 15 per cent export pick up, export diversification, and 8.2 per cent GDP growth could all end up in a mirage.

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