

## FY17 Budget and the trade policy mirage

Wednesday, Jul 20, 2016

By *Dr. Zaidi Sattar*

Budget season is all but over. The Budget for the fiscal year (FY), 2016-17, has been presented, discussed and debated, approved by Parliament, and finally delivered to the nation. As our octogenarian Honourable Finance Minister emphasised, inclusive and sustained growth is the central feature of this budget. We are reminded that the budget was designed to drive economic progress benefits of which will be broadly shared by the citizenry. Further, in keeping with Bangladesh's commitment to the post-2015 Sustainable Development Goals (SDG), the development approach being pursued attaches significant importance to sustainable use of our natural resources in a bid to protect the environment for future generations. The overall vision in the FY17 Budget appears fully consistent with the tenets laid down in the Seventh Five-Year Plan. One would have therefore hoped to see a greater focus on trade policy orientation of the growth process because, as the Seventh Plan argued, trade is pivotal for growth and employment creation. Does the FY17 Budget give trade policy the role it deserves in driving growth and employment?

The Budget makes the case that the economy, which despite heavy odds has earned kudos from a broad section of global analysts, is on track for higher growth with sustained macroeconomic stability. The targeted gross domestic product (GDP) growth for FY2016-17 is set at 7.2%, which is consistent with the Seventh Plan projections, and appears feasible on the back of a 7.05% provisional Bangladesh Bureau of Statistics (BBS) estimate of GDP growth in FY2015-16. Also largely consistent with the Seventh Plan formulations are most of the macroeconomic indicators like revenue, expenditure, and fiscal deficit as percentage of GDP, inflation, monetary and credit trends, private and public investment rates, balance of payments and exchange rate developments.

Perhaps for the first time in Bangladesh's economic history, we find annual budgets being

formulated in line with the philosophical vision, macroeconomic framework, and socio-economic goals delineated in the medium-term programme of the current Five-Year Plan. All this makes the Planning Commission's medium-term planning exercise more meaningful for the long-term. The relevance of five-year economic planning in the overall socio-economic development of the country can also be put to the test through mid-term and end-year review of goals and outcomes, provided annual budgets are broadly consistent with the economic philosophy and macroeconomic framework stipulated in the five-year plan.

In the backdrop of over forty years of development, we believe our policymakers now have a better understanding of what works and what doesn't in accelerating growth and poverty reduction in Bangladesh which is often cited as a 'model of development'. Relying on that experience, the Seventh Plan listed a number of growth drivers which, apart from the basic requirement of macroeconomic stability, savings and investment, included such factors as growing labour force and its quality, improving infrastructure and total factor productivity, efficiency of the financial sector, and export expansion and diversification through greater reliance on world trade. It is my humble view that sustained growth acceleration to the 7.0-8.0% trajectory will require a combination of all of the growth drivers - that is, firing of all cylinders at a time. Deficiency in effectiveness of any of the drivers is sure to undermine the desired or potential rate of growth. The Seventh Plan did make a point about stimulating growth drivers as the cornerstone of its growth strategy. It is in this context that mainstreaming trade and designing effective trade policy becomes critical for achieving the targeted growth acceleration over the medium-term. And each annual budget, FY2017 Budget included, is a building block towards achievement of that goal.

That brings us to a discussion of trade policy in the context of the FY17 Budget. And this is where it seems the budget parts ways from the approach and philosophy of the Seventh Plan in so far as industrial development and manufacturing growth is concerned. Whereas the Seventh Plan lays considerable emphasis on trade and export-oriented trade policy as the prerequisite for a dynamic and high-growth export-oriented manufacturing sector, the budget appears to lack a similar focus on export-orientation, the emphasis clearly going towards protection of import substituting industries. As I have pointed out so many times in the past, the two policies are not mutually exclusive and are very much in conflict with each other. Theory and evidence show clearly that the policy of sustained high protection to domestic import substituting industries creates an inherent anti-export bias of incentives to become a

drag on exports or its diversification.

It would be folly to argue that the budget is all about fiscal policy, not trade policy, as a good part of trade policy is subsumed in the revenue mobilisation approach in the 100-page text of the Budget speech. Indeed, the part dealing with revenue mobilisation through customs tariffs and para-tariffs actually constitutes the domestic dimension of trade policy. It is unclear if the ministry of commerce (MOC), whose mandate it is to rationalise the protection regime, is party to the formulation of this component of trade policy. MOC is typically engaged in driving the external agenda of trade policy that deals with export market access under multilateral, regional and bilateral trading arrangements. The domestic dimension that is exemplified by the protection regime is essentially left to the machinations of National Board of Revenue (NBR) by virtue of its control over tariff setting. That said, in paragraphs 205-206 of the speech of the Finance Minister one can glean the essential direction of the budget's trade policy stance. Ostensibly, the emphasis is on a mix of protection to domestic activities and mobilisation of revenue with the Customs Administration playing the dual role of revenue collector from trade transactions (imports and exports) and being arbiter of the protection regime.



We are aware that the budget is not formulated in a vacuum. The ultimate draft presented in Parliament is the result of a long period of public-private consultations but the predominant role seems to be played by stakeholders from business and industry. Consumers, who make up the largest group of stakeholders and who end up paying the protection tax, appear to lack voice in the pre-budget tariff-setting exercise. This raises serious questions regarding the proper balance of consumer and producer interests which more often than not are in conflict.

A summary of the FY17 tariffs placed in the context of past tariff trends (Table 1) tells much of the protection story — only marginal change. The 4.0% regulatory duty (RD) has been scuttled down to 3.0% after many years. What is new in the tariff structure is the introduction of a 15% tariff slab to the existing five: 1.0%, 3.0%, 5.0%, 10%, 15%, and 25%. While the new slab breaks the huge gap between 10% rate for intermediates and 25% for final consumer goods, it does provide the opportunity to offer protection to selected intermediate

goods, if needed, thus departing from the long tradition of only protecting final consumer goods. However, with supplementary duties being adjusted up and down, the average nominal protection rate (NPR) shows little change, being stuck around 25%, while the top NPR, a protection indicator of most import substituting consumer goods, is marginally lowered from 87% to 85%. That gives the signal that high protection to import substituting industries focused on domestic sales remains practically unchanged – or, is it a signal that lower protection is coming down the pike?

The budget speech makes the honest admission that “most of the proposals are intended for the appropriate protection of domestic industries including medium and small enterprises”. Rather than raise tariffs on outputs (finished product), to provide “competitive protection”, a term I have not heard before, most of the proposals stipulate reduction of input duties for selected protected sectors or sub-sectors (e.g. textiles, construction, electrical and chemical industries), all of which I might add have the benefit of the highest NPR of 85%. The net result is a further rise in effective protection to these industries. To be fair, some of these are indeed nascent industries deserving of time-bound protection, unlike others who appear to be perpetual beneficiaries of protection (e.g. biscuits and ceramics). But consumers got no relief from the tariff adjustments as the top customs duty rate has been stuck at 25% for the past 15 years topped off with a generous smattering of protective supplementary duties (SD).

Not surprisingly, at least on the trade policy front, the implementation of the new Value Added Tax (VAT) Law was aborted due to stiff resistance from protection-seeking industries that have come to rely on SD as the primary para-tariff for protection. By not starting a gradual process of rationalising SDs, by scaling back or making them trade neutral, NBR appears to have postponed for another year the difficult task of lowering protection and reducing anti-export bias of the protection regime.

The Seventh Plan has articulated a strategy for higher manufacturing growth coupled with export expansion and diversification predicated upon an export-oriented trade policy. For all its alignment with the Seventh Plan’s inclusive approach to growth acceleration, the FY17 Budget appears to have missed an opportunity to mainstream trade policy. It would have been good if the budget speech contained brief statements indicating our protection stance and underlying rationale for prolonged protection of industry without any reference to a timeline. In its omission, export-oriented trade policy in this budget remains more of a mirage

than a reality.