Looking East for new directions in trade and industry strategy

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While the streets of Bangladesh are tense and the political stalemate remains unresolved, any thought of new directions in economic strategy might seem quite out of place. Yet, if history is any guide, this cannot be everlasting. A decade or two later, we could reminisce about these days of national discomfort as short-lived episodic hazards of Bangladesh politics raising transaction costs of business. For the present, life has to go on and we will live another day hoping that tomorrow will be a lot better than what it is today.

Meanwhile, the global economy is on the move. Innovation and the process of creative destruction is the order of the day, with new opportunities beckoning entrepreneurs in Bangladesh no less. They can only ignore them at their own peril, something we can all regret later.

One such opportunity is being created by the new somewhat unnoticed trade and industrial revolution that has taken place in our backyard – East Asia. Back in the 1960s and 1970s, it was East Asia that showed the way to export-led growth for developing countries.

Again, it is East Asia that has emerged as the pioneers in integrating with cross-border production networks and trading in intermediate goods, the fastest growing segment of international trade, making up some 75% of East Asian commodity trade over the past two decades.

Participating in regional or global production networks or trading in intermediate goods has hardly played any role in Bangladesh's industrial evolution. It is therefore high time to reflect and take action before the train leaves the station, as it were.

After an initial decade of experimentation with import substituting industrialization, Bangladesh did come to terms with export-led growth as a strategy for income and job creation. That has paid huge dividends for the nation and promises to do so in the future.

Export markets are vast, and trade openness – in goods as well as in services – is likely to be the order of the coming decades, what with the rapid spread of automated procedures for movement of goods and services, global integration of production networks, significant reduction of transport costs, and modernization of ports, customs administration, and other trade infrastructure.

Going forward, export markets, rather than the limited domestic economy, will also be the main driver of employment for the vast number of labour force entering the labour market as an offshoot of the demographic transition the country is experiencing.

Though export markets are spread across the globe, bulk of the effective demand for our export products, dominated by readymade garments (RMG), has come from the West, i.e.

North America and the European Union (EU). As part of our strategy for geographical diversification of our export markets, it is now time to look eastward where, clearly, there is a growing market for our exports, in India, Japan, China, Australia, S. Korea, and the ASEAN countries en bloc.

However, to make the most of the emerging opportunities, a re-orientation of our approach to trade and industrial policy is critical. Because trade patterns are changing, creating opportunities as well as challenges for Bangladeshi exporters.

The structure and composition of manufacturing is changing with new features and processes replacing old ones. In a fast changing landscape of trade and industry, where will our comparative advantage be in future?

The Industrial Revolution had led to a proliferation of invention in process engineering in manufacturing leading to the "first unbundling" which occurred in the 19th century when the principle of 'division of labour' was applied to assembly lines popularized by Henry Ford in the automobile industry.

According to research done by UNCTAD-WTO-ERIA (Economic Research Institute of Asean), the "second unbundling" is now in progress giving rise to a new trend in the character of export-led growth. It is the 'unbundling' of production across countries fostered by widespread trade liberalization, advances in information communication technology (ICT), and lower transportation costs. This allows entrepreneurs to 'unpackage' their factories and locate various production stages (tasks) across countries in accordance with each countries' respective comparative advantage.

The fragmentation of production processes across different countries has given rise to global value chains (GVCs) creating opportunities for intra-industry trade globally as well as between contiguous economies within a region. This is the new type of international division of labour, and it turns out that East Asia currently has the most advanced production networks in the world, particularly in electronic and machinery industries.

International trade theory involving transaction costs see "production networks" being feasible only when speed and tight coordination among production blocks are effective

through swift service links that ensure quick, high-frequency, synchronized transactions in the manufacturing sector. This is found typically at the regional level such as in East Asia, or potentially in South Asia, rather than globally. This latest configuration of production networks and trade integration inevitably fostered a boom in intermediate goods trade, which has over the years become a major driver of export growth particularly in East Asia and other emerging economies of Asia.

In the 1970s, at a time when developing countries were saddled with non-performing import substituting industries that failed to generate high growth, several East Asian countries (S. Korea, Taiwan, Hong Kong, Singapore) showed the way to prosperity through rapid export-led growth.

In the 21st century once again, East Asian countries, including members of Association of South East Asian Nations (ASEAN), are showing the way in exploiting GVCs created by production networks held by multi-national companies (MNCs) from developed as well as developing nations. Thanks to these production networks complimented by high-frequency synchronized trade transactions, trade in intermediate goods has become the fastest growing segment of international trade. Some three-fourths of trade of East Asian countries is in intermediate goods.

The lesson? Capital-strapped developing countries no longer need to invest in huge plants and equipment to produce final goods, but can specialize in the production and trade in parts and components of final goods, all according to each country's comparative advantage.

That scenario seems to fit well with the Bangladesh context characterized by capital scarcity, labour abundance, and the proliferation of small and medium enterprises (SMEs) in the manufacturing and service sectors. The potential is vast but a number of constraints stand in the way.

First, Bangladesh exports predominantly final goods (98%) and intermediate goods in the export basket are all but absent.

Second, domestic production of import substitutes is concentrated in final consumer goods which receive high tariff protection while intermediate goods production (e.g. light

engineering, parts and components of electrical or electronic products) receive little or no protection. Indeed, a review of tariff trends show a secular decline in input tariffs (including those on intermediate goods) undermining any incentive for directing investment in the direction of intermediate goods production. Thus, in the manufacturing sector, effective protection (i.e. policy support) on consumer goods has been rising at the expense of protection on intermediate goods – a clear anti-intermediate goods bias of trade policy.

Third, whereas a lot of policy attention has been focused on developing linkage industries for the RMG sector, with significant positive results, precious little attention has been given to the economy's linkage industries, i.e. intermediate goods industries. Consequently, Bangladesh continues to have a negligible share of intermediate goods in overall manufacturing. Though it has been popular to highlight the dynamism of the small entrepreneurs in the light engineering sector, its profitability under the present tariff regime is low resulting in stunted growth from poor access to institutional finance from the banking sector.

Finally, to exploit GVCs, (a) import-export procedures need to be streamlined in order to ensure high-frequency synchronized transactions within production networks. For this, Bangladesh must fully implement the trade facilitation agenda of the World Trade Organisation (WTO) making effective use of copious resources made available by development partners; and (b) Bangladesh has to invite MNCs by creating a welcoming foreign direct investment (FDI) environment in order to integrate domestic production enterprises with cross-border production networks.

This is a tall order but one that can take Bangladesh to the next level of export-led growth with a diversified export basket that comprises significant share of intermediate goods from a rising competitive and diversified domestic industrial base.

As in the 1970s, East Asia is offering a new model of export-led growth for the world. A number of East Asian developing economies have taken advantage of the mechanics of production networks and have successfully moved up the ladder of industrialization. Singapore, Malaysia, Thailand and the Philippines went through this process by the late 1980s and early 1990s. China accelerated the process of participating in production networks, particularly from 1992. Indonesia, Viet Nam and India began the process in the

mid-1990s and 2000s. Cambodia, Lao P.D.R. and Myanmar are now about to jump on the bandwagon. Can Bangladesh afford to be left behind?

The foremost challenge is to redirect industrial and trade strategy to capture the opportunities unfolding in the East. Opportunities beckon, but the challenge is formidable. Bangladesh must move fast in order not to miss the bus.