

Looking for trade policy directions in the FY18 Budget

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Much of the pre- and post-budget public discourse has centred around one aspect of the Fiscal Year (FY) 2018 Budget – the launch of the new Value Added Tax (VAT) Law: The VAT and Supplementary Duty Act 2012. Almost five years late, the onset of the Law, as proposed in the Budget, has caused nothing short of an uproar in the business community. As the Budget awaits final endorsement by Parliament, we are told the firefighting is still on.

Little if anything is heard about the budget's implications for trade policy – as if it did not matter. The Government budget is not all about revenue mobilisation and allocation of public expenditure. A big chunk of it has to do with setting directions of trade policy, i.e. the domestic policy content of how exports will be stimulated and imports will be managed through the imposition of tariffs and para-tariffs. Though the tri-annual Import Policy Order and Export Policy Order framed by the Ministry of Commerce (MoC) make up the regulatory regime for import-export transactions, the fact that quantitative restrictions on imports no longer exist for protection purposes, these Orders no longer constitute trade policy per se.

After two decades of double-digit export growth, that particular leading indicator of our economy is faltering. Exports in FY2017 are expected to record a meagre 4.0 per cent growth, well under 10 per cent growth for three years in a row. This happens at a time when Vietnam's exports at \$177 billion grew 9.0 per cent in 2016 and is expected to grow at 7.0 per cent in 2017 to \$188 billion, raising its share in the US market by 1.0 per cent to 11 per cent when Bangladesh exports remained at 5.0 per cent. That should set off alarm bells. A change of course in trade policy coming out of the budget statement was reasonable to expect. That did not happen. Sadly, the initial assessment of the budget's stance on trade policy suggests we are left with much of the same.

This does not augur well coming at a time when the global context for export expansion from developing countries is facing strong headwinds stemming from the protectionist sentiments unleashed by the America First tirade of Trumponomics on the one hand and the populist upsurge in Europe castigating globalisation and free trade, on the other. At least in Europe, sanity appears to be prevailing as evidenced by the French and Dutch elections that rejected right-wing extremist politicians from gaining power. Even the Brexit (Britain's exit from the European Union or EU) move of the UK has come under public challenge. Though the world economy is not yet out of the "slow growth" syndrome, the latest version of IMF's Global Economic Outlook is projecting modest uptick in global growth of output as well as trade. What this means for Bangladesh exports is that while there are challenges ahead, global demand for Bangladesh's exports should remain steady in the near to medium-term. That is because Bangladesh is technically a small economy in global trade and should be able to sell all its exports in the world market provided they are cost competitive. So the trade policy challenge for Bangladesh policy makers is to maintain export momentum by sustained cost competitiveness.

Bangladesh's competitiveness by virtue of low labour cost is all too well known. Our wages are by far the lowest amongst comparators, partly compensating for lower productivity. However, a review of exchange rate trends reveals that though nominal exchange rate (e.g. Taka per dollar) has been fairly stable, Real Effective Exchange Rate (REER) has been appreciating for the past five years. Bangladesh's REER, which adjusts the nominal exchange rate for differences in domestic inflation and those of its main trading partners, has been trending upward since FY11 (up 54 per cent), because domestic inflation has far exceeded inflation rates in major export destinations, such as the USA and Europe. REER appreciation for the past five years gives a clear sign that cost competitiveness of our exports is being eroded. Though exchange rate management is a matter for the Bangladesh Bank, which cannot reduce inflation to the US and EU levels in short order, exporters were hoping that the Budget speech would contain some guidance for the central bank to contain the appreciation of REER via a modest depreciation of the nominal exchange rate.

The status quo is undermining export competitiveness while import-substitute industries are unable to become globally competitive and become export industries. For sectors that produce for exports and domestic sales (e.g. plastics, electrical goods, agro-processing, footwear), exports are generally less profitable than domestic sales in a protected market.

This situation can only change if a concerted effort is made in rationalising the protection regime. The new VAT Law, which included the scope for rationalising the supplementary duty (SD) structure, could have augured an era of moderate protection even if the SD proposals were even partially implemented.

But the budget proposal tabled in Parliament has completely sidetracked this critical policy issue at a time when that was most needed. Based on a preliminary assessment we find that the proposed budget has arrested the declining trend in import tariffs since FY13 while the average nominal protection has edged up by about 3.0 percentage points in FY18 (Table 1). Some 120 tariff lines saw SD increases while 53 were reduced. On average there was an increase in SD as well. That means the modest rationalization of tariffs that was taking place in the past three years has suddenly been reversed. Sectors that were enjoying the highest nominal protection rate of 85.6 per cent will now have the benefit of a higher rate of 92 per cent, thanks to an increase in SD.

The overall vision in the FY18 Budget appears consistent with the goals laid down in the Seventh Five Year Plan, viz, GDP (gross domestic product) growth, inflation, investment. But that is where the consistency ends. The budget seems to lack a trade policy orientation of the growth process. The Seventh Five Year Plan (2016-2020), which was fully endorsed by the Ministries of Finance and Planning, was approved at the highest echelon of Government before its launching. The Seventh Plan 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 FY18 Budget appears to contravene its (Seventh Plan's) trade policy orientation for rationalising protection in order to boost exports. 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 the absence of such statements we are left wondering if trade policy has any direction.