Seeking trade policy directions in the FY2020 Budget

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The timing is such that FY2020 Budget portends to be a policy document of critical national importance. FY2020 marks the end-year of the 7th Five Year Plan. Preparations for the 8th FYP are afoot and the groundwork for mediumand long-term strategies has to be laid no later than this year. Like other annual national budgets, therefore, this budget will be much more than a narrow instrument of fiscal policy. Its impacts will be spread across the sphere of macroeconomics, trade, employment, growth and social equity, among others. That makes it a formidable bellwether for the future directions of the economy and society. In a rapidly developing market economy like Bangladesh, the budget symbolises the visible hand of the state in gearing the development machinery in the proper direction to attain national goals.

Though one-year is short-term, being the first budget of the new Government under a new Finance Minister, all eyes will be on every statement made to decipher the underlying focus and stance of overall economic policy of the current political regime. It must address a host of questions all at once. Can it be pro-poor, pro-employment, and pro-growth all at the same time? If my reading is right, it will be business and investment-friendly like never before, considering the fact that so many business leaders are in the Cabinet and in Parliament and the economy is crying out for more investment – in infrastructure, health, education, industry, agriculture, and services. But it is up to the Government to strike a realistic balance between business and national interests, between producer and consumer interests, and so many other competing claims on scarce national resources. We look forward to the FY2020 Budget giving the right signals so that the economy is fired on all cylinders to sustain 7-8%+ annual GDP (gross domestic product) growth for the next five years as Bangladesh prepares to graduate out of LDC (least developed country) status in 2024. Entrepreneurs and investors are watching and waiting for the right signals that will drive growth-oriented resource allocation in the economy. More of the business-as-usual cannot be the answer at this challenging moment in our economic destiny. The expectation is for some visionary if not radical changes in policy direction.

Will the budget be trade-oriented and export-friendly? Among the least talked about constituent of the budget is trade policy. Yet, more than any other live policy document, the FY2020 Budget will set the tone and directions for and signal the stance of trade policy for the next few years. What will that stance be? Will it be more of the same or a notable change in approach to trade as a critical driver of growth and employment? Given that considerable inputs into the budget is being channelled through private sector leadership, effective trade orientation of the budget geared favourably towards exports and their diversification would be a reasonable expectation.

Willy-nilly, a big chunk of the budget 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 the non-binding Export Policy framed by the Ministry of Commerce make up the regulatory regime for import-export transactions, the fact that quantitative restrictions on imports no longer exist for protection purposes, these Government notifications no longer constitute trade policy per se. As the latest WTO Bangladesh Trade Policy Review (TPR) indicates, tariffs are the principal instruments of Bangladesh trade policy. The schedule of tariffs (and para – tariffs) on imports are set, adjusted, or confirmed under every annual budget, thus constituting the principal mechanism whereby the Government sets the direction of trade policy, not just for the ensuing fiscal year but also for coming years.

The 7th FYP ends with a positive note of achieving sectoral and overall growth targets. The challenge becomes more daunting as the 8th FYP has to target 8%+ average GDP growth during FY2021-25, in order to attain the economy's long-term goal of eliminating extreme poverty by 2031 and crossing the high-income threshold by 2041. Economic history presents no evidence of any country having achieved such growth acceleration without strong export performance. East Asian economies in the 1970s and China over the past 30 years posted stellar GDP growth all on the back of strong export performance. Rather than bask on the laurels of RMG exports alone our attention must be squarely focused on a diversified export basket. The past experience shows RMG exports still growing faster than non-RMG exports, thus resulting in more export concentration than less. If we take RMG out of the export basket, the rest of our exports appear anemic at best. The FY2020 budget must make serious efforts to change this scenario.

After two decades of double digit export growth, that particular leading indicator of our economy is faltering. Exports in FY2015-18 averaged only 5.0% growth, though it has started picking up in FY2019. This happens at a time when Vietnam's exports crossed $220 billion in an economy of $230 billion, and is still growing at 7%+ in 2019 with a fairly diversified export basket. That should set off alarm bells. A notable change of course in trade policy under the FY2020 budget is a national policy imperative.

First, taking note of the global economic trends the outlook appears modestly negative. According to the latest version of IMF's Global Economic Outlook the world economy is not yet out of the "slow growth" syndrome, and trade tensions are weighing in on trade as well as global growth. But the effects need not be catastrophic. 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.

Given that there is a significant backlog of incomplete reforms, there is indeed an urgency to act fast in addressing the priority policy and institutional constraints to improving Bangladesh's competitiveness. First, global markets are undergoing rapid technological transformation and trade integration with mounting competitive pressures. There is no option for Bangladesh but to strengthen its competitiveness and diversify its export in order to improve our export performance to engender faster growth. To ensure competitiveness, the Budget should announce creation of fast, hassle-free "export channels" for RMG as well as non-RMG exports at seaports, land ports and airports. Road and rail infrastructure will have to be upgraded to include "export lanes" in Dhaka-Chittagong corridor. That should include "import-for-export lanes" as well.

We have a mono-product export basket with 83% of our exports made up of RMG. Yet, over the past 10 years, Bangladesh has been exporting non -RMG goods numbering 1000 to 1300 products (at HS6-code level) mostly under $1.0 million in value (75% of non-RMG exports in FY2018). The potential for export diversification has not been fully exploited. For non-RMG exports in particular a strong case has been made for giving them the same treatment as RMG exports. Provision of duty-free imported inputs (through special bonded warehouse system) for non-RMG exports is a must to ensure competitiveness in the world market. A clear announcement to this effect would give traction to addressing the challenge of export diversification.

But competitiveness is not enough in the Bangladesh scenario, which is unique amongst developing countries. High protection to domestic industries and recurrent phases of exchange rate over-valuation create significant antiexport bias to divert resources away from non-RMG exports to importsubstitution activities. Protection-induced profitability from domestic sales is significantly higher than that from exports so policy is essentially skewed in favour of domestic sales. A priority trade policy agenda will be to rationalise tariff protection to balance incentives between exports and domestic production/sales of import substitutes. The 2019 WTO TPR stated that supplementary duties (SD) were being used for protection. With the exception of automobiles, alcoholic beverages, cigarettes, and firea rms, scaling down SD rates and making them uniform (to eliminate discriminatory rates) should be high on the FY2020 tariff reform agenda. Little known to most analysts in Bangladesh is the significant deterrence to non-RMG exports that stems from high protection. The FY2020 budget ought to have a clear statement on this fundamental conflict between our policy of industrial protection and the desire to diversify exports.

There is a lot of talk on FTAs with various countries. Typically, the first item in an FTA (free trade agreement) framework is tariffs and Bangladesh would have a hard time surmounting this first hurdle. Indeed, resistance from local protectionists would be so strong as to stifle any government move to reach an FTA with other countries. Note that an FTA is based on reciprocity, unlike preferential access regimes like EU’s Everything but Arms (EBA). The Budget ought to lay down a policy regarding the pursuit of FTAs.

We are on the cusp of graduating out of LDC status with a goal of crossing Upper Middle Income Country threshold by 2031 and High-Income Country threshold by 2041. Attaining both of these milestones will require growth acceleration to an annual average of 9.0% over the next 20 years. That is only possible on the back of strong trade and export orientation of the economy by leveraging the enabling effect of the global economy. Unless the FY2020 Budget recognises this reality and seeks to mainstream trade policy, we will have missed another year of opportunity.