Strengthening economic relations with the US

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By *Dr. Sadiq Ahmed*

Economic Analysis: Part I

Quite apart from its overwhelming presence as the global military-political-economic superpower, the US is also Bangladesh's largest source of foreign exchange earnings.

In fiscal year (FY) 2011, Bangladesh exported an estimated $5.0 billion worth of goods to the USA. It earned another $500 million of imports and $1.5 billion of remittance in the same fiscal. After taking all these figures into consideration, the net foreign earnings from the USA amounted to $6.0 billion, which was about 6.0 per cent of Bangladesh's annual gross domestic product (GDP) in FY 2011. However, when we compare our export earnings with total imports of the USA, which was $2337.6 billion in 2010, we have a negligible presence in the US market. The total GDP of the USA was estimated at $14.7 trillion. So, the potential for tapping more resources from the USA in terms of direct foreign investmentand remittances is similarly large. In view of this, a major policy question is: How well is Bangladesh prepared and making an effort to benefit from better economic relations with the USA?

A number of initiatives are underway to strengthen trade and investment flows between Bangladesh and the USA. On the Bangladesh side, one major effort has been to seek duty-free access to the US market for Bangladeshi exports beyond the Generalized System of Preference (GSP) list. From the US side, there have been efforts to conclude Trade and Investment Framework Agreement (TIFA). Both efforts have met with stiff resistance. Bangladesh is yet to get duty-free access to the USA; the USA has not been able to convince Bangladesh to sign the TIFA.

Clearly these stalled-efforts to strengthen economic cooperation are not in the interest of

Bangladesh and ways need to be found to move forward. There are a number of ways by which cooperation can be strengthened and a win-win situation for both countries can be ensured. These require a careful review of underlying issues, a pragmatic approach to resolving them, and more importantly finding ways to gain from existing unused opportunities.

It is well recognized that developing countries will probably benefit more from improved access to markets of industrial countries than through aid. With increasing budget constraints in donor countries and inefficiencies in aid administration and absorption, the role of greater trade and market access has become even more important. Tariff and quotas create barriers to market access. Unlike in the developing countries where tariffs are a major source of government revenues, in the developed countries these are instruments of trade protection and or economic diplomacy. Recognizing the difficulties for poor countries in getting market access, the European Union (EU) took a major policy initiative called “Everything But Arms (EBA)” under which all countries falling in the United Nations list of least developed countries (LDCs) have duty-free and quota-free (DFQF) access to the EU.

The US adopted a more limited policy for the LDCs by allowing this facility to only African LDCs under the “Africa Growth and Opportunity Act”. Bangladesh has been lobbying for quite some time to convince the US policy makers that this facility should be extended to the Asian LDCs as well. Although Bangladesh could potentially benefit from the GSP, presently the value to Bangladesh exports is very limited (less than 1.0 percent of its export base) as most of Bangladeshi exports to the US, especially readymade garments (RMG), is outside the GSP list of the USA. Some 95% of Bangladeshi exports to the USA comprise of RMG, which faces an average import tariff of 15.3 per cent.

The unusually high tariff on RMG in the USA is basically intended to give protection to domestic RMG producers. As a consequence, the US government has been reluctant to extend full duty-free access to Bangladesh. However, contrary to fear of loss market, the quota restriction on RMG that was lifted in January 2005, following the phase-out of the Multi fibre Agreement (MFA) that has been beneficial for Bangladesh in terms of improving market access to the USA.

Another reason why the granting of duty-free status is a contentious issue with the US administration is the fact that Bangladesh is now the third largest exporter of RMG to the USA (after China and Vietnam) and there is a concern that duty-free access to Bangladesh will give it unfair advantage over other competitors.

Irrespective of the merits of this political economy debate and while Bangladesh should continue to fight for duty-free access, it should also focus on ways to increase market penetration in the USA through product diversification.

Bangladeshi exports presently account for only 0.2 per cent of the US import market. There is no reason why it should not aim at doubling this share over the next five years. Here Bangladesh needs to learn from the examples of China, India and Vietnam. The additional earnings from this effort will likely far outweigh the benefit that may accrue from duty-free access. (The writer is vice-chairman, Policy Research Institute, Bangladesh. He can be reached at e-mail : sahmed1952@live.com)

Economic Analysis: Part II

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Strengthening economic relations with the US

Sadiq Ahmed

The demand for duty-free access to US market for Bangladeshi exports raises an important political economy issue. Just as Bangladesh rightly believes that 15.3 per cent US duty on readymade garments (RMG) exports is high and restricts market access, international firms argue that trade barriers into Bangladesh owing to high tariffs and a maze of supplementary duties restrict their export access into Bangladesh.

This is a major policy issue that requires attention of Bangladeshi policy makers. In our search for revenues, we have not paid adequate attention to the matter of inefficiency and resource misallocation conveyed by our import regime.

Quite apart from the question of improving access of the US and other exporters to our market, a rationalization of the import tariff and supplementary duty regimes with a view to substantially reducing average import protection will be essential for deepening and diversifying our export base. Access to duty-free capital and intermediate imports has been a major element for the success of the RMG sector. Other potential export activities will similarly benefit from a lower import duty regime.

Additionally, high trade protection on final goods distorts investment choices in favour of import substitutes as opposed to export activities. A lowering of the import protection on final goods will therefore help shift investments towards export by lowering the anti-export bias.

The other sticky point in Bangladesh-US economic relations is the refusal of Bangladesh to sign the bilateral Trade and Investment Framework Agreement (TIFA). The TIFA includes a number of areas of US concern that it seeks resolution through Bangladeshi compliance. The areas of concern relate to environmental standards, labour laws, intellectual property rights and anti-corruption policies. Bangladesh believes that the standards of compliance included in the TIFA cannot be implemented at this present stage of development.

Arguments of both countries have merit. The issues listed by the USA have important social and development implications and ought to be a part of Bangladesh's own development agenda and not just a matter of bilateral agreement. The challenge is to find a pragmatic approach to implementing standards that reflect the current socio-political and economic environment of Bangladesh.

A third area where policy attention will pay rich dividends concerns foreign direct investment (FDI) from the USA (and more generally). Bangladesh has missed out badly on this agenda. As of 2010 the total stock of FDI in Bangladesh stood at $6.1 billion as compared with $579 billion in China, and $198 billion in India. Even in Vietnam, the stock of FDI is $65 billion.

Annual flow of FDI into Bangladesh is still less than a billion dollar as compared with $188 billion in China and $25 billion in India. Regarding the US-based FDI, the annual flow has been dwindling in Bangladesh, falling to a negligible $43 million in 2009.

With an expanding rate of economic growth in Bangladesh, the demand for investment and imports is growing. FDI can provide additional financing for both investments and imports. In this regards, it is a major policy variable that could help reconcile the growth target with the target for stability of the balance of payments.

Additionally, FDI is a highly potent source of technology transfer that has major positive implications for increasing total factor productivity. This point is again well illustrated by the experience of the RMG sector. Strategic partnership with the Korean firm of Daewoo at the early stages of the evolution of the RMG sector paid rich dividends in terms of transfer of knowledge, technology and training that subsequently supported the expansion of this activity.

Strategic partnerships with the leading US firms in ways that have happened in the dynamic East Asian economies and are now ongoing in India can tremendously boost the development prospects for Bangladesh. The country needs to much better exploit its comparative advantage bestowed by nature in terms of human resources.

The benefit of harnessing low-cost labour advantage through the RMG sector is an excellent example of the potential for pushing this agenda further in other areas. The US manufacturing is now vertically integrated across the globe. There is no reason why Bangladesh should not strive to take a shareof this vertically integrated production process in areas where labour cost is dominant. There are plenty of products where Bangladesh can easily fit in the supply value chain.

The policy agenda for attracting FDI for exports is well known. This includes reducing the cost of doing business, improving trade logistics, reducing trade protection, improving infrastructure, enhancing labour skills and strengthening compliance with international standards of labour protection, environment and anti-corruption.

The US FDI can also play a strategic role in supplying some of the investments needed to meet the virtually unlimited demand for infrastructure services in Bangladesh. (The writer is vice-chairman, Policy Research Institute, Bangladesh. He can be reached at e-mail: sahmed1952@live.com)