



The imperative of trade policy reforms now

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A youth-driven revolution is a terrible thing to waste. The revolution has presented Bangladesh with a singular opportunity to undertake deep-rooted reforms in critical areas of the economy and society

The Chief Adviser of the interim government, Nobel Laureate Professor Muhammad Yunus, has given a firm but terse message on the path forward, encapsulated in the 3Rs: reset,

reform, restart.

This is exactly what is also needed in the trade policy arena which has been languishing without much reform for the past decade and a half. Policy stasis had gripped the reign of three past finance ministers who showed little or no interest in overdue trade policy reforms, as they were lulled into complacency by decent export and remittance performance and rising forex reserves.

The only redeeming feature was the ratification of WTO's Trade Facilitation Agreement (TFA). But that actually covered spending on soft and hard trade infrastructure rather than moving forward with trade policy reforms. So now is the time for a second round of trade policy reforms, the first round having been left half complete in the early 1990s.

Trade has been a handmaiden of Bangladesh's development over the past three decades. Between trade and growth, however, lies trade policy. Restrictive trade policy inhibits growth. To keen observers of the Bangladesh economic scene the trigger that unleashed the forces of rapid economic growth would have to be the radical change of direction in trade policy (complemented by market orientation and deregulation) that was launched in the early 1990s by the then Finance Minister, Mr Saifur Rahman. He literally bulldozed trade liberalising reforms despite the populist uproar that emerged from academic and business circles. Indeed, his successor in 1996 termed these reforms "too much, too fast" and set about slowing down or even reversing some of them.

What were those reforms that caused so much brouhaha for almost a decade? Compared to the previous 20 years, the trade policy changes undertaken could be termed radical indeed and included (a) sharp reduction and rationalisation of tariffs, (b) significant import liberalisation through removal of bans, quantitative restrictions (QRs) and import licensing (end of licence raj), (c) move from fixed to flexible exchange rates, and (d) limited convertibility of the current account. This time trade liberalisation during the early 1990s was deep and transformative.

In 2001, a seminal World Bank study on the impact of trade liberalisation on growth and poverty (David Dollar and Art Kraay, *Trade, Growth and Poverty*, published in *The Economic*

Journal) listed Bangladesh among the “globalisers” of the developing world, confirming through empirical evidence that these globalisers were experiencing rapid growth in incomes and declines in poverty.

The 1990s was truly the golden period of trade policy developments when you consider the whole gamut of radical changes in the trade policy regime that were launched at the start of the decade. At the close of the 1980s the economy was literally in shambles. GDP growth was anaemic, foreign exchange reserves had reached rock bottom, and financing of the Balance of Payment (BOP) deficit was at a crossroads (sounds familiar?).

The confluence of an economic and political crisis (collapse of Ershad regime and onset of democracy) paved the way for radical reforms. The economic mess left by the departing regime had to be cleared first to restore the economy’s potential for growth and poverty reduction. The World Bank-IMF stepped in to save the situation with structural adjustment loans and BOP support on the back of wide-ranging trade policy reforms.

Much needed structural reforms were introduced that included measures for restoring internal macroeconomic stability through fiscal conservatism, market orientation and deregulation of investment, and privatisation of state-owned enterprises, a la Washington Consensus – stabilise, liberalise, privatise.

It is fair to say that nowhere in the economic policy space was there such a radical change of direction as in the case of trade policy. Evidence shows that Bangladesh massively reaped the benefits of those changes in subsequent decades.

In my view, switching gears in trade policy in the 1990s, from an inward-looking import-substituting policy to an outward-looking export-oriented trade policy was by far the game changer. Though the trade policy arena in Bangladesh has been crying out for second generation reforms, we are left holding the incomplete set of first-generation reforms that dealt with tariff reduction and import liberalisation.

Clearly, much more is needed to make the Bangladesh economy more dynamic in the 21st century context of stiff competition with global value chain integration and rising trade in the intermediate goods segment.

Is Bangladesh trade policy dynamic enough to seize global opportunities in the 21st century? Where does Bangladesh stand as it prepares to graduate out of LDC status and will be faced with stiffer international competition with substantial erosion of trade preferences? In my view, despite the export success that global analysts give Bangladesh credit for, it would be a mistake to describe the current Bangladesh economy as characterised by a high degree of trade openness.

What happened was that the initial spurt of liberalising trade reforms in the 1990s soon gave way to creeping protectionism with the invocation of para-tariffs in the tariff structure that created a highly protected import-substituting manufacturing sector alongside a 100% export-oriented readymade garment (RMG) sector operating within a sort of free-trade enclave.

What thus emerged was a “dualistic trade and industrial regime” that yielded notable export success, but on the back of RMG exports. Export performance in non-RMG exports has been feeble, if nonexistent, resulting in a highly concentrated export basket with RMG constituting almost 90% of overall exports in 2024.

While exchange rate management has been brought up to date by moving into a flexible exchange rate regime recently, the crux of the problem now lies in the tariff structure which remains high and complex when world tariffs are down to an average of 5-6%, while that of lower middle-income countries (LMIC) is 7%, compared to Bangladesh’s average tariff of 27%.

More important, there are para-tariffs, such as protective Regulatory Duties and Supplementary Duties, that may run afoul of WTO after LDC graduation. It is for the tariff structure alone, not to speak of other non-tariff barriers (NTBs), that the Bangladesh economy – at least a substantial part that caters to import-substituting industrialisation – has to be identified as having a restrictive trade regime. And foreign investors shy away from countries that have open trade regimes.

In the past, the Bangladesh economy has earned praise from analysts across the globe for its export and growth performance and is on a path to winning the war against poverty. But close to home we find an ominous tendency towards ossification that has gripped the Bangladesh tariff structure.

A closer look at the tariff developments during the two decades of the 21st century points towards a stalemate in the tariff structure, particularly during the latter period.

Average nominal tariffs (NPR), after declining sharply in the 1990s, was ascendant for much of the past two decades. Tariffs are trade restrictions. Rising average tariffs and total trade taxes indicate more restrictive trade. This needs to be reversed. But there are forces against this reform.

First, NBR seems inherently resistant to tariff reduction on grounds of potential loss of revenue. But this argument now falls flat in light of the nearly 40% exchange rate depreciation over the past 18 months that has resulted in an across-the-board equivalent (40%) spike in all tariff rates without NBR moving a pen. Shaving off half this spike should not be revenue reducing but will have a disinflationary impact on inflation, thus killing two birds with one stone. IMF's BOP support and WB-ADB budget support could provide the resources to ameliorate any adverse consequence.

Second, even the protection argument is no longer valid because, in principle, the exchange rate depreciation is the equivalent of a rise in tariffs on both input and output, thus raising effective protection by the rate of depreciation.

Bangladesh's persistent history of protectionism in its tariff regime poses a significant challenge to exports. Despite sporadic attempts at tariff rationalisation, the regime remains laden with WTO-non-compliant para-tariffs, hindering export diversification. As long as domestic import substitution remains more profitable than exports for non-RMG products, export diversification will remain elusive. Thus, the tariff regime remains a binding constraint to export diversification.

The sooner we can come out of our antiquated tariff regime and make our tariff structure reflective of a dynamic export-oriented economy the better our chance of diversifying our exports and fueling post-Revolution economic recovery with a bustling diversified export-driven manufacturing sector that creates jobs and income to win the war on poverty.

One promising development was the launch of the National Tariff Policy 2023, for rationalisation and modernisation of Bangladesh's tariff structure to bring it in tune with the

dynamics of competitive global trade. But implementation of NTP 2023 was halted largely due to politically driven interventions. Now is just the time to get it rolling.

National Tariff Policy 2023 marks a significant step towards tariff reforms in alignment with WTO guidelines. Unlike previous approaches, the policy focuses on introducing time-bound protection for sectors with high potential rather than blanket protection for infant industries. This strategy is particularly relevant given Bangladesh's impending LDC graduation, aiming to enhance competitiveness through gradual tariff reduction and increased import competition.

Moreover, the policy introduces a novel scheme allowing duty-free import of inputs for firms engaged in both exports and domestic sales, akin to the Special Bonded Warehouse (SBW) system for RMG exporters. This move addresses a long-standing demand of non-RMG exporters, promising a level playing field and facilitating their global market presence. This measure, if implemented, opens wide the doors for export diversification.

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Likewise, it presents another chance to reform Bangladesh trade policy to fit in with the evolving global trade landscape of the future. The Interim Government must seize this opportunity to unleash the economy's full potential for competing in the world market with a diversified export basket.

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