



The nexus of trade and development: Bangladesh and East Asia in historical perspective

Tuesday, Dec 14, 2021

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Throughout history, trade has been the lifeline of nations and communities. The modern interpretation of 17th century English Poet John Donne's "no man is an island" expression would be the interconnectedness of people around the world through trade in goods and services. For countries on the path of development international trade has become the driving force for creating jobs, raising incomes, and lifting millions out of poverty. Bangladesh is one such developing nation that has defied the odds of resource constraint, burdened with

a massive population, to achieve notable success in accelerating growth with macroeconomic stability.

A rich body of evidence shows the importance of openness to the world economy through trade and investment in fostering growth and reducing poverty. Among others, a trade-led strategy of development has been at the core of Bangladesh's record of economic progress of the past 25 years. It was in the 1990s decade that Bangladesh made the 'leap of faith' into the world of trade openness by switching from an inward-looking import substituting trade strategy to an outward looking export-oriented regime which earned it the title of "globaliser" among developing economies, by none other than the World Bank. The economy reaped the benefits of the regime switch in terms of export growth, job creation, and poverty reduction. In 2010, a Wall Street Journal report on Bangladesh was captioned "Basket Case No More", citing notable progress on human development aspects of infant mortality, education, life expectancy, women empowerment and rural development. But the main focus of that report was Bangladesh's export success in apparel exports in which it rose to become No.4, after China, EU, and Turkey. Even that is history now with Bangladesh rising to No.2 for nearly 10 years running until Vietnam played catch up.

Trade strategies and development strategies are intricately correlated, particularly for developing economies aiming to raise income and rapidly grow out of poverty. Development entails structural transformation, from agriculture to industry, and within industry, a rising share of manufacturing. Of late, structural transformation has included the servicification of economies with rising share of modern technological services (such as IT) replacing informal service activities. That said, development literature since the 1960s has treated industrialisation as being synonymous with development of underdeveloped economies. But the path to industrialisation has required different versions of trade policy orientation, some of which yielded successful outcomes, others not so.

A bit of history helps to bring in the right perspective. Though international trade was a sine qua non of life from ancient times, the prevalent approach to trade in the 17th-18th centuries was mercantilism. While the classical economists highlighted the gains from free trade based on comparative advantage, mercantilists were in favour of regulating cross-border trade so that national wealth was augmented through exports with a minimum of imports. The industrial revolution, which began in Europe, in this scheme of things, meant that colonies

would be the suppliers of raw materials while colonial powers supplied finished products, like textiles and machineries. In spite of these countervailing forces, international trade accelerated during the 19th and early 20th century until the Great Depression, when economic progress was disrupted. Beggar-thy-neighbor tariffs sparked up in one country after another leading to sharp reduction in trade volumes which further aggravated the Depression. Perhaps the Second World War and wartime production saved the situation and fueled economic recovery in the USA and the world at large.

The lessons of the Depression years showed the criticality of international trade for global economic wellbeing. World leaders took note and founded the Bretton Woods system in the post-War period with multilateral regimes that would foster trade openness through reduction of tariffs and other restrictions on international trade. The world community reaped the benefits of that system for nearly 70 years as trade growth fueled income growth across continents. Yet, in the 1960s a different mantra of trade became the accepted wisdom – import substituting (IS) industrialisation – for most developing economies rising out of colonial bondage. This development strategy involved restrictive trade policies that was adopted by many regions of the world including South Asia, with adverse consequences for economic progress in these regions. A different path to trade and development – trade openness and export-led growth – was carved out by East Asian countries. That remains the prevailing development paradigm till today with some variation that evolved over time.

Historical and cross-country evidence shows that the practice of trade policies fall into two broad categories: inward-looking import-substituting trade policy and outward-looking export-oriented trade policy. An alternative way of framing this categorisation would be to relate them to the markets that are in focus – the domestic market for the former and the export or world market for the latter. The rationale for import substitution (IS) as a development strategy was based on its foreign exchange saving potential for economies that suffered from scarcity of foreign exchange and IS production was destined for the domestic market to replace competing imports.

After the Second World War the prevailing wisdom for industrialisation of developing countries was the adoption of import substitution strategy, a la Prebisch-Singer hypothesis. Clearly, it was not yielding results as growth remained slow and industrialisation fell short. In the 1960s and 1970s, several East Asian countries (Korea, Taiwan, Hong Kong, Singapore)

abandoned the IS stance and went for export orientation on an intensive scale.

The result was path-breaking giving rise to the paradigm of export-led growth – described by the World Bank as the East Asian Miracle. It was also called an outward-oriented strategy, a strategy that meant not biasing incentives in favour of import-competing industries catering to the domestic market. The strategy was to provide roughly equal incentives between export production and import substitution. It is important, in this regard, to note that outward-looking does not mean more incentives for producing for export than for the domestic market. It does, however, imply relatively uniform across-the-board incentives for exports, and an industrialisation strategy that relies on rapid growth of exports.

Research evidence is plentiful showing that the IS strategy neither yielded rapid industrialisation nor robust growth. On the other hand, there is overwhelming evidence confirming that economies embracing export-oriented strategies targeting external markets have grown rapidly. For many East Asian economies export orientation was so intensive and industrialisation was so rapid that they turned from poor countries to become developed economies within the span of under 50 years. There is no such historical evidence of rapid development or structural transformation of economies using the IS trade strategy.

One critical point that needs mention is that export-oriented policies in practice have most often been accompanied by appropriate exchange rate management that kept the exchange rate from being over-valued, a phenomena that clearly retards exports. There is no denying that the exchange rate is a pivotal policy variable in the conduct of trade policy. Research evidence shows that countries that relied on export push for rapid growth also ensured long periods of depreciated exchange rate. What is critical for successful export push is to avoid any over-valuation of the exchange rate. This was the mistake made by economies that took to import substitution as their trade policy orientation. It was common for them to resort to extreme currency over-valuation combined with quantitative restrictions on imports resulting in the equivalent of prohibitive tariff protection. Overvaluation of the currency stifles export growth, reduces foreign exchange earnings leading to further restriction on imports often in highly irrational and indiscriminate ways. Governance of IS strategies has been the subject of research in many developing economies.

Finally, the case for export-oriented development came out strongly in the report of the

Growth Commission set up by the UN in the early 21st century and led by Nobel Laureate Michael Spence. One important conclusion that came out of that research was that unlike in the past centuries, developing economies could now grow at rates of 7,8,9, or 10, by leveraging demand in the global marketplace, something the domestic market cannot offer. Trade economists like Anne Kruger argued strongly that the domestic market of most developing economies was too small to offer the kind of scale economies that the global economy can provide.

The global market is just too big so that no single country can affect world prices. That means, basically, that you can export and grow as fast as you can invest, provided you have some competitive edge. East Asian countries, eager to develop rapidly, realised this early on in the 20th century. And East Asian economies continue to show the world new variants of export-led growth in the 21st century.

While theories about the gains from trade originated from the minds of thinkers and thought leaders in Europe and North America, the practice of leveraging international trade, based on comparative advantage, to transform poor backward economies into prosperous and developed economies within a time frame of 50 years originated from the leaders and governments of East Asian countries. East Asia led the way for other developing economies to emulate.

As mentioned earlier, first it was Korea, Taiwan, Hong Kong, Singapore, in the 1960s and 1970s. Then it was China in 1978 under Deng Xiaoping, who opened up a hard communist country for trade and foreign investment, calling it socialism with market orientation, giving China 30 years of 10 per cent-plus growth. China advanced the idea of export-led growth not only by instituting trade openness but by opening up its socialist economy, still dominated by state-owned enterprises, to foreign investment to become one of the leading recipients of FDI inflows (about \$148 billion in 2019) in the developing world. Rapid growth for three decades at a stretch has not only lifted 650 million people out of poverty but the size of its economy is about to overtake the US economy by 2030 assuming its current growth persists.

Now it is the turn of another communist country, Vietnam, starting with Doi Moi reforms in 1984 which instilled another dose of trade and market orientation into a socialist economy. The results are before us. Vietnam did not just stop at embracing export-led growth but went

well beyond it taking full advantage of the phenomenon of “globalization” to give a 21st century version to the paradigm of export-led growth. What we have is actually trade-led growth bolstered by THREE new distinctive features of modern international trade: (1) unfettered FDI, (2) expansive regional and bilateral FTAs, and (3) cross-border global value chain (GVC) integration.

This is not export-led growth based on standard comparative advantage principles driven by local resource endowment. Much, if not all of its export success – in manufactured products – is driven by foreign invested enterprises. The government and local entrepreneurs welcomed foreign investment without reservations. That created a momentum of export growth not seen since the early days of the East Asia Miracle.

So what was the thrust of Vietnam’s trade policy?

1. a) COURTING EXPORT-SEEKING FDI: Since the mid-2000s, the Vietnamese government has offered extremely competitive financial incentives to businesses seeking to set up operations in the country, in addition to a zero per cent withholding tax on dividends remitted overseas and a low corporate income tax (CIT) rate of only 20 per cent. To top it all, FDI regulations called for minimal local content requirement – a typical FDI inhibitor. FDI in Vietnam has not only brought copious amounts of capital but created skill-based jobs, infused innovation, improved management, opened retail windows in developed country markets, upscaled to higher value added apparel (of man-made fiber) and electronic products, and so on. But FDI came for exports not the domestic market.
2. b) COURTING FTAS: Vietnam has aggressively signed FTAs — most notably, RCEP, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), EU-Vietnam FTA (EVFTA) plus a few more bilateral FTAs (e.g. Japan, Australia, New Zealand). Vietnam has attained near-zero duty access covering 70 per cent of world GDP and 50 per cent of world trade. It is the combination of FDI and FTAs that makes Vietnam a competitor to be reckoned with over the long term.
3. c) COURTING GVCS: In apparel and electronics, Vietnam has pursued an overwhelmingly FDI route and GVC without regard to domestic value addition, receiving FDI inflows of \$28 billion (11 per cent of GDP) in 2020. The objective has always been to expand exports and capture world markets thus creating jobs at home. In apparel it

imports 85-90 per cent of inputs (i.e. fabrics and accessories) and in case of electronics import share is even more.

A notable feature of Vietnam's export success is the strategy of least concern with local value addition in exports. Domestic value addition in exports is extremely low as evidenced by the fact that exports of \$281 billion in 2019 exceeded Vietnam's GDP of \$260 billion. That happens to highly trade-oriented economies (e.g. Singapore). Most countries impose limits on equity holding, local content requirement etc. Perhaps the strategy here is to first absorb and accommodate big and small multinationals, give them the confidence and security of return on investment, and then seek spillover gains over the long-term in innovation, technology, management, skill-development, and the like for local enterprises. London-based weekly, *The Economist*, in its analysis raised concerns about sustainability of this approach to development based on heavy reliance on foreign invested enterprises. But Vietnam's strategy is clearly to embrace FDI hook line and sinker before worrying about spillover effects and local value addition which are inevitable consequences of FDI over the long-term.

True, Bangladesh's export success has been limited to one manufacturing product group - readymade garments (RMG) - but that is in itself a major transformation for an economy that began exporting only primary products like jute, tea, and shrimps in the 1970s. Putting a densely populated developing economy on the world map of manufacturing exports was itself a validation of the fundamental proposition in international trade - gains from trade based on a nation's comparative advantage which in turn is driven by factor (resource) endowments. It was strong confirmation of the time-tested principle of comparative advantage laid out by classical economists Smith-Ricardo-Mill. Apparel making was a labour-intensive activity and Bangladesh's abundant cheap low-skilled labour was just the resource needed to produce and exchange competitively in the world market. But that also needed creation of a level playing field in the world marketplace. That is where multilateralism and Bangladesh's trade regime come into play.

The strategy of export-led growth built on the back of trade liberalising policies had finally taken hold in the policy space. The liberalising reforms of the 1990s, albeit incomplete, generated enough momentum to stimulate export-oriented manufacturing growth, job creation, and poverty reduction for the next two decades, and the momentum continues to this day. Average decadal GDP growth began rising by over one percentage point every

decade, 4.8 per cent in FY91-00, 5.9 per cent in FY2001-10, and 7.2 per cent in FY2011-19. The moderate poverty rate which was 57 per cent in 1990 was nearly halved by 2010 (31.5 per cent), and is estimated to be around 20 per cent in 2019 – highly effective sign of inclusive growth. Like everywhere else, the onslaught of the Covid-19 pandemic has clearly disrupted the steady path of economic progress as well as poverty reduction during 2020-2021, but there are signs that a robust global output and trade recovery is underway and Bangladesh hopes to reap the benefits of that recovery through a rejuvenation of its export strategy in order to return to its pre-pandemic growth path.

Recently, 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. It would be a fair assessment to suggest that Bangladesh energetically launched first generation trade reforms in the 1990s and is still reaping the benefits of those reforms in terms of export, growth and poverty impacts.

But tariff reform, one critical ingredient of trade policy, still remains largely unfinished with some ossification evident in recent times. Can the economy achieve its medium-term goals without modernising its tariff structure? As I have argued in many fora and writings, the current tariff regime is a major stumbling block to the realisation of export diversification – a priority development agenda of the government.

As the nation addresses trade facilitation as part of second generation trade reforms, completing the unfinished agenda of trade and tariff reforms begun in the 1990s and taking them to their natural conclusion should be a national imperative that will yield rich dividends on way to Bangladesh becoming an Upper Middle Income Country by 2031. Bangladesh recently gained the epithet of “The New Asian Tiger” from the international business media (e.g. Bloomberg News), a tacit comparison to the East Asian Tiger Economies (S. Korea, Taiwan, Hong Kong, Singapore) of the 1960-70s.

In the year 2021, the 50th anniversary of Bangladesh’s independence and the centenary year of Bangabandhu’s birth, the economy stands at a historical inflexion point. It is the ideal turning point in the country’s history to launch a major reform initiative in the realm of trade policy to instill the kind of growth momentum that was experienced by economies in East Asia over the past 70 years. The momentum is clearly evident. It has the potential to grow at

sustainable rates of 7 per cent +. But opportunities opening up in the global marketplace of the 21st century must be seized through aggressive trade and supportive economic reforms, like the East Asian economies did and are still doing, if Bangladesh is to live up to the reputation of resilience and dynamism that it has earned so far, defying the geopolitical doomsayers once and for all.

Bangladesh, at 50, has earned a respectable place in the comity of nations, no longer to be derided as a “basket case”, but to be surely acclaimed as a “development paragon”. It is time to drop the narrative that its economic and social achievements are “paradoxical” in light of poor governance. The fact is fighting for economic freedom is in our DNA just as fighting for political independence.

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