# Trade openness hits speed bump

Monday, Jun 22, 2009

By *Dr. Zaidi Sattar*

Trade openness appears to have been a casualty in this budget. You might have to look hard to see it. Because it is not so readily apparent. Let this be explained.

Despite stiff resistance from domestic lobbies, trade openness in Bangladesh has been making progress, albeit gradual, for nearly two decades, with the result that total trade – merchandise exports and imports – now make up 45 per cent of the country's gross domestic product (GDP), from under 20 per cent in 1990. This writer is one who believes this has done good to the country, barring some inevitable social costs. Every budget since 1992 contained policy changes that contributed to opening of trade; may it be removal of bans or quantitative restrictions on imports, reduction of duties, the elimination of non-tariff barriers, or streamlining of export procedures. When you add it all up, the picture changes: Bangladesh is transformed from being a rather closed economy with high trade barriers in the early 1990s, to an economy that is relatively open now. The budget speech of the Finance Minister avers by stating that Bangladesh's trade policy is now "liberal and largely open". However, during the same period, other countries seem to have pursued policies of trade openness with more vigour, thus leaving Bangladesh's relative position quite unchanged. World Bank's Global Trade Restrictiveness Index ranks Bangladesh 97th amongst 125 countries.

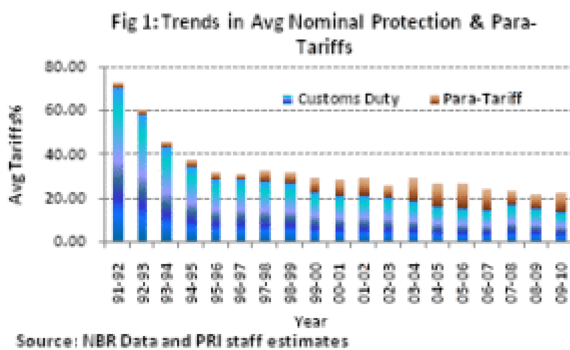
Trade policy was not the centerpiece of this budget. It was never meant to be that way, though budget outcomes mould trade policy as no other government policy does. This budget is no exception. After five years of six per cent plus GDP growth, the economy survived the onslaught of the global financial meltdown with an enviable 5.9 per cent growth for the year, thanks to the lack of integration of our financial markets with global financial centers. Our concern remains limited to the subsequent global recession characterized by slowdown in

consumption demand and associated investment which will eventually take a bite out of our export performance and remittance flows. So when it came to the trade agenda, the tone of the budget speech was somber. The acknowledgment that trade liberalization would be kept on hold until we are out of the woods as far as the global economic recovery is concerned could be taken to mean “don’t expect major tariff reductions this time around”. Fine. But to see tariffs go up – and protective tariffs at that – comes as something of a surprise, as it signifies not a standstill but a reversal of the past slow but sure momentum in the direction of trade openness.

Two of the sweeping tariff changes are worth a close examination. One is the reduction of the rate of duty for the class of imports described as basic raw materials. The rate for these items has been cut from 7.0% to 5.0%. This would be good for local industries producing for the domestic market as their production costs would go down and profitability – but not necessarily productivity or efficiency – will rise. This policy change is unlikely to spur investment which depends more on the ‘investment climate’ than a tariff adjustments. The other sweeping change lies in the imposition of a 5.0% Regulatory Duty (RD) on all imports now subject to the top rate of 25% customs duty (CD). Now, roughly 40% of all tariff lines (2863 out of 6450) have this rate, and one-third of these items have a 20% Supplementary Duty (SD) slapped on top. Since SD is calculated on duty-inclusive value, the real effect is equivalent to 25%, making the top rate of duty, effectively 50%. That was up until FY2008-09. Budget 2010 has added a 5.0% RD on all tariff lines with CD rate of 25%. Note that RD, as an extra para-tariff, was eliminated in 2003 and subsumed under SD, as a measure of simplifying the tariff structure. Also, with a similar objective, the across-the-board 4.0% Infrastructure Development Surcharge (IDSC) was eliminated in FY2007-08 and subsumed under CD for various categories of imports. Being an across-the-board tariff, IDSC was more equitable than the proposed RD which falls mostly on consumer goods.

The ostensible goal of the revenue authority is probably to augment revenues. But economic analysis would suggest the opposite outcome. Here is why. By and large, imports subject to the top rate are final consumer goods. Those that have domestic production (import substitutes) are also subject to the 20% SD, some of which have now been raised to 45%, and some others, like biscuits, chocolates, and lozenges, have risen to 100%! Included in this selected list of import substitutes are consumer products ranging from toothbrush, paper products and mineral water, to kitchenware, plastic goods, and ceramic tiles, doors and

furniture. There is synergy between revenue and protection objectives up to a point, after which high tariffs will only protect by restraining imports and resulting in negative revenue outcome. The net result of the two adjustments mentioned above is that protection to local industry has gone up, so prices of most local products bought by middle class consumers will be higher, but any increase in import revenues will be modest at best. This writer is not sure this has been carefully analyzed.




The overall outcome of the tariff adjustments is computed in terms of average nominal tariffs, which is an economic concept, somewhat different from a simple averaging of tariff rates. ForBangladesh, the protective effect of each tariff and para-tariff has to be factored in, before averaging. For instance, VAT and SD, which were introduced in 1991 as trade-neutral import taxes, have lost their neutral identity – the SD, more than VAT. So, the protective eff/ects of these rates, as well as the protective implications of trade VAT (2.25%) and advance income tax (AIT), have all to be factored into the computation of nominal protection. A preliminary computation of the average nominal tariff for Budget 2010 yields an estimate of 22.9%, compared to 20.1% for FY 2008-09. This rise in average nominal protection is a departure from the historical trend of gradual decline since the start of trade liberalization in the early 1990s (See Fig. 1).

It might be argued that there is more to trade policy than a few tariff adjustments. It turns out that after trade-related quantitative restrictions on imports have been eliminated, tariffs and para-tariffs remain the main instrument of trade policy in Bangladesh. So average tariffs pretty much captures the broad direction of trade policy. At the two Group of Twenty (G20) summits on the global economic crisis, there was a consensus that countries will not raise their protection levels in order to let the stimulus packages have their intended global impact of expanding global consumer demand through open markets. World Trade Organisation (WTO) was given the responsibility of monitoring protectionist developments.It might be argued that Bangladesh need not worry since it has only bound 15% of its tariff lines under its WTO obligations – that also around 200 per cent, for agricultural products. Its applied

tariffs being much below bound levels, one would think there is plenty of head room for raising tariffs. Being a least developed country (LDC), it can also claim special and differential treatment.
In principle, that might be okay. But two immediate concerns will be cause for some unease in bureaucratic quarters. Bangladesh expects to lay claim on its share of the stimulus resources placed with multilateral organizations. These tariff adjustments might not sit well with those assigned to review our trade policy developments. Even the expectation that multilateral donors like the World Bank might be willing to finance a bigger chunk of the budget deficit might hit a snag on grounds of the rise in protection levels, not to mention that proposed changes in Public Procurement Rules are already a bone of contention. It will take all the development diplomacy that Bangladesh can muster to draw higher amounts of concessional project aid, let alone resources for budget support which are usually contingent upon a critical mass of reforms.

To sum up, it all adds up to a rather daunting agenda for the Finance Minister in the coming year that will need much more than good cheer from his domestic and external constituencies. We know from his record of service that he is no quitter. We wish him well. (Dr. Zaidi Sattar is Chairman, Policy Research Institute of Bangladesh. Research support was provided by PRI’s Tamzidul Islam Chowdhury. The writer can be reached at e-mail: zaidisattar@gmail.com)