Trade policy and industrialisation in Bangladesh

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Trade policy arguably is one of the most contentious policy issues in modern times. Witness the ongoing policy debate in the US national elections. The ultra-right wing Donald Trump seeking the Republican Presidential nomination is leading a virulent attack on liberal trade policies, while at the same time liberal left wing politician Bernie Sanders fighting for the Democrat Party ticket is equally vociferous about the evil consequences of trade liberalism for the US economy.

This common and highly toxic attack on trade liberalism from two opposing sides of the most advanced industrial country of the world is dangerous for global prosperity and is based on a populist perception that the US is losing jobs to China and Mexico by letting cheap imports flood the US markets. Neither candidate has offered any quantitative evidence about how by simply imposing high trade tariffs the US productivity and employment problem will be resolved. Neither is there any explanation about how the loss of purchasing power of consumers from the increase in domestic prices owing to high tariffs will be compensated. Politics indeed makes strange bed-fellows.

In Bangladesh, support for trade liberalisation is also very weak. Although the country has come a long way from the bad old days of large quantitative restriction and heavy tariff rates, trade reforms have faltered over the past several years. Critics believe that cheap imports are threatening the manufacturing sector growth and trade protection is needed to boost the sector and create more jobs. Although in reality trade policy has been guided more by revenue considerations than by trade protection, nevertheless trade policy reform has taken a back seat in recent years partly on protection grounds.

The combination of revenue and protection considerations has complicated trade policy implementation. While custom duties have come down, para-tariffs in the form of supplementary duties have mushroomed (Table 1). As a result, the top nominal protection rate (NPR) has increased significantly and the average NPR has also been increasing since fiscal year (FY) 2008-09.

Importantly, the effects of these para-tariffs on trade protection have been almost random with no strategic view on the expected pattern of industrialization (Table 2). The average effective rates of protection (ERP), defined as value-added in domestic prices including tariffs as a per cent of value-added in world prices, ranges from zero for exports to as high as 273% for footwear.

An important question is: has the resulting trade protection supported the expansion of manufacturing and job creation in Bangladesh?

The trend of manufacturing sector value-added between 2005-06 and 2013-14 by major product groups is summarised in Table 3. The main results are:

1. Between FY 2005-06 and FY 2013-14, the leading manufacturing activities have been ready-made-garments (RMG) and textiles. They spurred manufacturing expansion by growing faster than total value-added in manufacturing. As a result, their share in total manufacturing value added expanded from 26% in 2005-06 to 49% in 2013-14. Both are leading export activities and benefitted from duty-free imports for inputs.
2. All other manufacturing except furniture making grew much slower than the average manufacturing growth thereby losing value-added share.
3. Furniture grew somewhat faster than total manufacturing, increasing slightly its share.
4. The inescapable conclusion is that trade liberalisation has helped export-oriented manufacturing in RMG and textiles but protection did not spur other manufacturing growth. In the case of furniture making, there is a natural comparative advantage provided by high transport cost and low labour cost. So, the role of trade protection is unclear.

Faced with this evidence, it is hard to defend trade protection as a rationale for industrialisation. Bangladesh has achieved tremendous success in increasing the growth of manufacturing sector based on the expansion of RMG and the backward linkage provided by textiles. RMG has been a leading source of export earnings, now accounting for 77% of total export earnings from goods and non-factor services.

The primary reason for the expansion of RMG exports is the comparative advantage of Bangladesh from having an abundant, low-cost labour. Bangladesh has successfully converted this comparative advantage by combining it with other enabling factors including competitive entrepreneurship, duty-free imports of raw materials, back-to-back letters of credits (LCs), technology transfer from abroad and in-house labour training. These cost advantages have more than offset the disadvantages presented by weak infrastructure and poor trade logistics.

In the case of other manufacturing, the positive factors available to RMG were not generally available and as such the strong negative effects of weak infrastructure, poor trade logistics and land procurement problems have been overwhelming. Trade protection does not address these underlying constraints.

The way forward is obvious. Bangladesh must move strongly to address the fundamental constraints that slow down the expansion of the manufacturing sector (land acquisition; affordable energy; low and reliable domestic transport; easy and low-cost port handling). It should then facilitate the factors that have supported the growth of RMG: duty-free imports of raw materials; back-to-back LCs, transfer of technology through direct foreign investment, in-house labour training supported by government-sponsored training and broad-based progress with quality education. Trade protection as a norm should be sparsely used only when evidence suggests that the protected activities will gain comparative advantage based on learning-by-doing.

The main aim of industrial policy should be to convert the huge advantage provided by abundant supply of low-cost labour into gains for manufacturing. The example of RMG suggests that focusing energy on other labour-intensive exports can have huge pay-offs.

In this regard, product quality is of essence. Partnership with good international investors that can support technology transfer and help with the branding of the export product can be very helpful.

Utmost attention should be given to labour training, particularly in-house labour training, along with continuous efforts to ease the infrastructure constraint and the swift implementation of the government’s policy for special economic zones (SEZs) aimed at easing the land constraint for manufacturing.