Interview: Dr. Zaidi Sattar_‘Under the current tariff structure, exporters are better off not exporting’

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INTERVIEWS

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‘Under the current tariff structure, exporters are better off not exporting’

The Business Standard interviewed Dr Zaidi Sattar, Chairman of the Policy Research Institute (PRI), to better understand the issue of trade reforms

Dr Zaidi Sattar. Sketch: TBS

With the fall of the Berlin wall on 9 November 1989, the illusion of prosperity under a state-controlled – mostly nationalised – socialist economy also withered away. The then Government of Bangladesh would soon adopt a more global approach to its economic machine.

Over the 1990s, the government went on to introduce a wide range of quasi-liberal policies, later termed by many pundits as the first phase of trade reforms.

This phase of reforms promised economic prosperity and thankfully, prosperity soon ensued.

Over the next 20 years, Bangladesh, a nation once decried by the Westerners as a 'bottomless basket', came of age, marked by its graduation from a least-developed country.

While many rejoice, Dr Zaidi Sattar, Chairman at the Policy Research Institute (PRI), sounds the alarm of caution and warrants the execution of a second phase of trade reforms to kickstart Bangladesh's journey as a developing country and prevent potential bottlenecks in its progress.

Dr Sattar's warning came at a webinar organised by PRI on 1 March titled 'Boosting Bangladesh's Trade Competitiveness'. The Business Standard team sat down with him to discuss the inefficiencies of the current tariff regime and the most prudent way forward.

You have called for the modernisation of the tariff regime. What is the problem with the current system?

The country has already gone through the first phase of trade reforms which included substantial reduction and rationalisation of tariffs in the 1990s, later followed by increased exchange rate flexibility as well as current account convertibility. The ongoing economic boom is largely attributable to these policies.

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Recent studies, however, found some peculiar divergences; best manifested in tariff policies over the past 20 years. The tariff rate for imports of inputs, juxtaposed against those for goods and services, reveals a pattern of differential treatment that favours importing factor inputs over final consumption goods. Consequently, the effective protection of local industries from tariffs is increasing, despite decreasing tariffs on imports of inputs. This makes Bangladesh an outlier in the global tariff regime.

Could you elaborate on how this discrepancy in tariff rates affect the trade competitiveness of Bangladesh?

The existing tariff structure serves as a disincentive to export and a barrier to diversification. Exporters, especially of goods that have both domestic and international demand, only

export when the profit incentives in the international market are higher than that of the domestic market.

However, because of the high protection of consumer goods, the domestic producers hardly face any competition from imported goods, as they are significantly more expensive. That is, under the current tariff structure, exporters are better off not exporting; barring any significant progress in diversification.

What changes would you propose be introduced as part of the second phase of trade reforms? How would these policies affect trade competitiveness and export diversification?

If we want to diversify our exports, the current tariff structure has to be modernised and the tariffs on imported consumer goods must be reduced. While there are other problems such as inefficiency of the customs system, under-developed infrastructure, etc., they affect RMG as well, but have not been able to halt its exports growth. What's uniquely problematic for the consumer goods exporters is the high tariff protection that serves as a disincentive to export, and that has to change.

Photo: Mohammad Minhaj Uddin/TBS

In terms of the exchange rate, trade economists have long argued in favour of a flexible exchange rate. Bangladesh Bank (BB) adopted a flexible exchange rate system in 1991 which paved the way for tremendous growth in trade. In the 2003-04 fiscal year, we moved on to a managed float exchange rate system.

However, we began to notice that price differentials across countries, actually made exports from Bangladesh somewhat less competitive. For instance, the average inflation rate in Bangladesh revolves around 5%, which for our largest trading partners in the EU and the US is around 2%. Adjusting for the price differentials would require the central bank to depreciate the currency regularly to keep the exports competitive, much like Vietnam and China. Contrarily, the real effective exchange rate in Bangladesh has appreciated over time. This is why you often see RMG exporters urging BB to depreciate the currency.

BB argues that depreciating the currency will create inflationary pressure. In that case, I

would recommend a compensated depreciation, where if you depreciate the exchange rate by 5%, you also decrease import tariffs by 5%, to neutralise the price effects. That is, a 5% depreciation, in a way, is equivalent to a 5% subsidy across the board.

Photo: Mohammad Minhaj Uddin/TBS

On top of that, we need to provide benefits like bonded licence facilities for duty-free import of inputs, and back-to-back LCs. We did it for the RMG industry in the past and look where it got us. We need to do the same for the other industries as well to diversify our exports basket.

In terms of regional cooperation, what sort of trade deal should Bangladesh sign to make itself more competitive in the global market? Should Bangladesh be part of multilateral organisations like RCEP or should it focus on bilateral FTAs?

Much of the economic progress experienced by the European Union can be attributed to the free movement of goods and services across the border. Unfortunately, the level of economic integration in South Asia remains very low, thanks to the intense political borders that separate the countries.

Now the ideal trade agreement beyond the WTO should be a free-trade agreement (FTA) based on comparative advantage. A free-trade agreement would imply a zero tariff and non-zero tariff regime. Although we have SAFTA, Bangladesh, in all practicality, is not a part of any such FTA.

The primary barrier to FTA in Bangladesh is the uniquely high tariff barrier. The average protective tariff in Bangladesh now is 26 percent. For consumer goods, it is 45 percent. In comparison, the average tariff for low-income and middle-income countries are 11 percent and 5 percent, respectively. For Vietnam, one of Bangladesh's principal competitors in RMG exports, the mean rate of tariff is 6 percent.

Photo: Mohammad Minhaj Uddin/TBS

Because of the high tariff barrier, Bangladesh prefers to sign PTAs or preferential trade

agreements. But it’s neither here nor there and the gains from such arrangements are negligible.

What are the barriers to tariff reforms or signing FTAs in Bangladesh? What does it have to do with the so-called infant industries?

The infant industries in the country have become geriatric infants. We started by saying that we would protect the infant industries from foreign competition. To justify this decision, the protection had to be time-bound. The assumption was that these industries would become more efficient and competitive during the years of production and would be able to compete once protections were lifted. For instance, the biscuits industry in Bangladesh, to this day, receives protection over 100 percent. However, after decades of protection, this has become a political issue. The industry leaders have accumulated considerable political capital and lobbying power which prevents fruitful tariff reform.

You mentioned that factors service exports like remittances should be recognised for their role in poverty reduction and rural development? Could you please elaborate on the contribution of remittances?

Cross-country comparisons often come in handy when trying to understand how the balance of payment (BoP) varies across countries. While most countries exhibit similar trends, the case of Bangladesh – among a few other countries – is rather unique; particularly in terms of the transactions incorporated within the BoP calculation.

This uniqueness stems from the high rates of migration from Bangladesh, remitting billions of dollars back home and constituting a sizable share of its foreign reserve. Interestingly, remittances, despite their contribution, often remain overlooked in the discourse surrounding trade.

Picture: Bloomberg

Instead, much of the discourse regarding trade predominantly prioritises the exports and imports of non-factor goods and services, i.e., merchandise trade. What we miss out on is the role of factor exports, i.e., the role of migration and subsequent remittance inflow on our

balance of payments. The penchant for glossing over a crucial factor export like migration is particularly salient in the discussion regarding export diversification or the resilience of the economy.

We observed significantly higher remittance inflow during the Covid-19 pandemic, as opposed to earlier fiscal years. Would you say that the higher remittance inflow absorbed much of the shocks of the pandemic?

Although non-factor exports and factor exports have different transmission mechanisms, their impact on the economy, to say the least, is consistent. Typical merchandise exports increase the production of certain goods, flourishes certain industries and fosters growth in employment. A low unemployment rate – typically accompanied by high aggregate demand – can insulate the economy against exogenous shocks.

Factor services like migration usually translate into high remittance inflow to the ones left behind in the country of origin. In almost all cases, remittance inflow encourages households to consume and demand more goods and services, which on a micro level, cushions the migrant households from sliding into poverty. On a macro level, the higher demand – like in the case of merchandise exports – leads to higher production and can drive the economic machine.

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