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Fifty years of the evolution of trade policy in Bangladesh

Photo: AFP

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The country celebrated the golden jubilee of independence this year, and there is indeed much to celebrate. Analysts of all shades of opinion have hailed the quality of social and economic progress achieved by the country which was, at inception, derided as a "basket case" by none other than Henry Kissinger, the then US secretary of state. Bangladesh emerged in 1972 with a per capita income of under USD 100, at the bottom of the income pile, in the company of such nations as Chad, Rwanda, Burundi, and Nepal. Today, having crossed the per capita income threshold of USD 2000, with a GDP of USD 325 billion, it ranks in the top 40 economies of the world by GDP.

The growth momentum it picked up in the 1990s has not lost steam yet. The minor dip in fiscal year (FY) 2020 growth notwithstanding, over the past two decades, Bangladesh has recorded the fastest rate of GDP growth among developing countries. Any economy that consistently records six to seven percent GDP growth per annum for two decades has to experience significant augmentation of income per capita accompanied with substantial reduction of poverty. The economy and society also undergoes momentous transformation as a consequence. That is exactly what has happened in this country of 166 million people.

What were the key drivers of this notable transformation? Of course, there were positive political and social developments that planted the pillars of stability and inclusiveness in the transformation process. In my view, the general direction of economic policies was broadly consistent with the fundamental tenets of macroeconomic stability that laid the foundations for rapid growth and poverty reduction. 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) during much of the 1990s. It is now possible to make the assessment that after the first two decades of prevarication in trade policy, Bangladesh was able to change course and get it right—at least partially so. In my assessment, nowhere in the 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 the subsequent decades.

In the 1970s, trade policy as an instrument of development never seemed to have been on the radar. The priority agenda was addressing massive poverty and fuelling economic recovery, largely through domestic policies supported with donor assistance. By default, the trade policy stance was a legacy of the past—where East Pakistan was turned into a captive market for West Pakistani financial and industrial corporates via high tariffs and import controls, resulting in an inward-looking import substituting economy. Starting with zero foreign exchange reserves to pay for much needed imports, high tariffs and import controls were found to be the expedient approach to keep from falling into a balance of payments crisis.

The notable industrial and trade policy innovation (indeed, we can call it that) came with the special dispensation formulated for the readymade garments industry at the end of the decade. The innovation was the grant of duty-free importation of inputs and back-to-back letter of credit (LC) facility to cover import costs, to be paid from export proceeds. Taking advantage of this facility, Desh garments, set up by an influential civil servant, collaborated with the Korean firm, Daewoo, to launch a 100 percent export-oriented enterprise to access Western markets under the multi-fibre arrangement (MFA) that offered export quotas for Bangladesh. Thus was born Bangladesh's leading manufacturing sector, that would exploit Bangladesh's comparative advantage in labour-intensive production and create millions of jobs, particularly for women. The rest is history.

There were three notable developments in the trade policy arena during the 1980s. First, there was widespread disenchantment over import substitution—which restricted imports to grow domestic industries—as a strategy of development, because there was growing evidence that this approach neither generated competitive industrialisation nor fuelled growth. On the other hand, protectionism tended to perpetuate itself, leaving numerous inefficient firms in its wake, as "infant" industries failed to become competitive and needed higher protection over time to survive. Second, departing from the import substitution regime, a new development paradigm—export-led growth—had emerged out of the tremendous export-led growth successes of several East Asian economies (described by the World Bank as the East Asian Miracle) in the 1960s and 1970s. By the 1980s, this new paradigm had got a firm foothold in development discourse. Third, there was the Washington Consensus—a set of free-market economic policies that emphasised *inter alia* trade liberalisation and was promoted by multilateral institutions such as the International Monetary Fund (IMF) and World Bank (WB)—which gained currency among development institutions and most development practitioners.

Inexplicably, these significant developments in the policy sphere got little attention from policymakers in Bangladesh. Thus, as far as trade policy developments in Bangladesh are concerned, the 1980s was a lost decade. There was little traction in mainstreaming trade policy as an instrument for development as the government took no initiative to bring trade policies into the development discourse. When trade-related actions were taken at the prompting of multilateral institutions, it tended to be episodic (for example, tied to some World Bank loan) and limited to tariff liberalisation for specific imports or sectors, without a holistic approach towards the overall extent of trade openness or measures to augment competitiveness.

The only notable development was the tariff liberalisation for imports of agricultural inputs, which complemented the deregulation in domestic agricultural markets—for seeds, fertiliser, machinery and implements. The general trade policy stance did little to improve the balance of payments (BOP) situation, nor did it fuel GDP growth, which was anaemic throughout the decade, culminating in the BOP crisis of 1990. What could be levelled as a missed opportunity was the lack of an effort to adopt the new paradigm of export-led development. Thankfully, that changed in the subsequent decade.

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 BOP deficit was at a dead end. The confluence of an economic and political crisis (collapse of the Ershad regime and the 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 WB-IMF stepped in to save the situation with structural adjustment loans and BOP support on the back of wide-ranging trade policy reforms, in addition to measures for restoring internal macroeconomic stability through fiscal conservatism, market orientation, deregulation of investment and privatisation of state-owned enterprises, *a la* Washington Consensus.

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 the license Raj), (c) move from fixed to flexible exchange rates, and (d) convertibility of the current account. This time, trade liberalisation during the 1990s was deep and pervasive. In 2001, a seminal World Bank study on the impact of trade liberalisation on growth and poverty (by David Dollar and Art Kraay, titled "Trade, Growth and Poverty" and published in *The Economic Journal*) listed Bangladesh among the "globalisers" of the developing world, confirming that these globalisers were experiencing rapid growth in incomes and decline in poverty.

In hindsight, we can argue that the WB findings signalled the dawn of a new era of trade openness that fuelled rapid growth and poverty reduction in Bangladesh with the advent of the 21st century. 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. Average decadal GDP growth began rising by over one percentage point every decade—4.8 percent in FY91-00, 5.9 percent in FY2001-10, and 7.2 percent in FY2011-19. The moderate poverty rate, which was 57 percent in 1990, was nearly halved by 2010 (31.5 percent), and is estimated to be around 20 percent in 2019—a highly effective sign of inclusive growth. These positive developments notwithstanding, a closer look at the tariff developments during the two decades of the 21st century points towards a stalemate in the tariff structure during the latter part.

Unlike the 1990s, the first decade of the 21st century saw a slowdown in tariff reduction and other trade reforms. The reform highlight of this decade was the move from flexible to floating exchange rate (a managed float, actually) launched by Bangladesh Bank in 2004, along with a final elimination by the Ministry of Commerce of all bans/QRs on imports for protection reasons. The latter was done through a modest scheme of tariffication of the last remaining QRs on textile imports. One para-tariff, the infrastructure development surcharge (IDSC) was eliminated and absorbed with custom duties (CD). But no sooner was this chapter closed, another para-tariff, the regulatory duty (RD) of three percent across the board, emerged in FY2010. It is fair to say that with that closed the chapter on tariff reforms. RD, which by law has to be renewed every year, has gained a life of its own and it looks unlikely to be abandoned any time soon. As confirmed by the World Trade Organisation (WTO) in its 2019 Trade Policy Review, tariffs and para-tariffs are now the principal instruments of trade policy in Bangladesh.

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; but close to home we find an ominous tendency towards ossification that has gripped the Bangladesh tariff structure. Trade economists have long argued that export performance and tariff protection are not mutually exclusive. Tariffs on import substitute production are indirect subsidies that undermine support to exports and create anti-export bias. The sooner we can come out of this antiquated tariff regime and make our tariff structure reflective of a dynamic export-oriented economy, the better our chance of post-Covid-19 economic recovery, with a bustling export-driven manufacturing sector that creates jobs and income to win the war on poverty. This is exactly the strategy laid out in the Eighth Five Year Plan, recently approved by the Prime Minister and launched by the Bangladesh Planning Commission.

After the 2020 *annus horribilis,* a terrible year, the Bangladesh economy finds itself at a crossroads. The challenge to revive exports and grow at an average of eight percent over the next five years has never been more daunting as graduation from Least Developed Country (LDC) status beckons. 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 reforms, one critical ingredient of trade policy, still remain 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.

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As the nation addresses trade facilitation as part of second generation trade reforms, completing the unfinished agenda of the trade and tariff reforms begun in the 1990s and taking them to their natural conclusion should be a national imperative, which will yield rich dividends on the way to Bangladesh becoming an upper middle income country by 2031.

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