TRADE LIBERALISATION IN BANGLADESH

Who Gained, Who Didn't, and Why

It is surprising that some of the critiques of trade reform in Bangladesh have complained of a flood of imports having a devastating effect on the import-competing industries, and reducing the breadth of the country's industrial base. This is not even supported by the (deficient) Quantum Index of Industrial Production which shows a rising trend in the 1990s for the bulk of manufacturing, with the exception of some import-competing activities.

by Tercan Baysan and Zaidi Sattar

DESPITE broad agreement amongst analysts, policymakers and businessmen, on the need as well as inevitability of trade liberalization in Bangla-desh, its pace has been the subject of some debate laced with criticism from many quarters. This article, based on findings of a recent World Bank study, argues that positive impacts — both in terms of improvements in productivity and overall economic performance — have been substantial enough to outweigh the costs, if any, from the speed of liberalization. On the whole, we find sufficient evidence to conclude that trade liberalization has been a positive sum game. Bangladesh's trade liberalization effort started in the mid-1980s and picked up pace in the early 1990s as an important component of Bangladesh's structural reform programme. Initial steps were ad hoc and focused on the removal of quantitative restrictions (QRs), but in the early 1990s a more comprehensive trade policy reform programme was put in place. It covered both tariff and non-tariff barriers, though there was no pre-announced implementation schedule or phased programme targets. Significant progress was made in removing QRs, and in reducing the maximum and average tariff rates.

However, since the mid-1990s the pace of tariff rationalization toward a lower and uniform rate has slowed due to concerns over budgetary revenues, the balance of payments, and, in particular, possible adverse effects of trade liberalization on the import-competing industries. Although much remains to be accomplished, the country deserves credit for achieving substantial progress in removing trade barriers and embracing a largely open economic system (trade volume as a measure of openness rose from 16 per cent of GDP in FY89 to 30 per cent in FY98). Despite the lowering of trade barriers, export production still suffers from substantial anti-export bias (measure of the extent to which production for import substitutes is favoured over exports). Coupled with additional costs stemming from infrastructure bottlenecks, corruption, law and order situation, the production for exports is still at a competitive disadvantage, and a large number of potential export activities are unable to take off.

Has Trade Liberalization been Too Fast?

There is a tendency to compare Bangladesh's trade liberalization experience only with those of its neighbours. Except for Sri Lanka, the other South Asian countries particularly India, have been very slow in liberalizing, thus presenting perhaps a poor benchmark for comparison. When compared to other liberalizing countries of the world, Bangladesh's trade liberalization over a period of 8-10 years does not appear particularly fast. Many countries in South East and East Asia, Latin America, and even some in Africa achieved significant cuts in average tariffs and reduced the range of their lowest and maximum rates over a period of five to eight years. And most of these countries have benefited from positive impacts on export growth and thereby GDP growth. What has been missing from the trade policy reform process here is the advance announcement of a programme of planned policy changes. This has obviously contributed to the perception that trade liberalization was too fast, since some domestic firms were caught unprepared.

More mileage could have been gained from announcing planned trade reforms in advance giving time to the private sector to adjust. Further, the benefits of liberalization were undermined by the high cost of doing business resulting from poor infrastructure, such as power shortage, clogged ports, inferior and inadequate telecommunications network. If these problems were suitably addressed, the gains from liberalization would be much greater.

While it is difficult to quantitatively establish a direct causality from trade liberalization to economic performance in general and to GDP growth in particular, Bangladesh's overall economic performance — in terms of export, manufacturing sector and GDP growth rates, external balances—appears stronger in the 1990s than in the 1980s, providing evidence that trade liberalization has not been harmful. On the contrary, it appears to have contributed, together with other market-oriented reforms and sound macroeconomic management, to improved macroeconomic performance. Increased availability of cheaper and higher quality imported raw materials, intermediate inputs, capital goods and new technologies, and enhanced competitive pressures have been obviously important factors in producing these positive results.

Has Domestic Production Been Displaced?

Trade liberalization does open the economy to foreign goods and competition. A balanced growth of exports and imports is desirable for economic development. Under sound fiscal/monetary and exchange rate policies, trade liberalization should not lead to destabilizing developments in external accounts. At the micro-level, however, there is no denying that inefficient firms that fail to improve their competitiveness despite long periods of high protection will find themselves under pressure, losing markets, shedding labour, or exiting markets if they are not viable, as the progressive removal of trade barriers establishes a more neutral incentive regime. Such displacements are expected to affect inefficient firms, and should not be a basis for arguing against trade reform. Activities that are more profitable in the post-liberalization phase would be expanding and generating new jobs, with the pace depending on how conducive the business environment is in facilitating supply response. If widespread production and job displacements were to take place, such hypothetical adverse impacts would be reflected in poor sectoral and aggregate economic performances — not evident in Bangladesh. Trade liberalization has resulted in a significant increase in the merchandise trade-GDP ratio (almost doubled); yet it has not led to an unsustainable trend in the merchandise trade deficit. With faster growth in exports, a much larger proportion of import costs are now covered by merchandise exports, which are also more diversified than in the 1980s, though there is still a high degree of export concentration. In the external accounts, the trade deficit as a share of GDP has remained fairly low (averaged only 2.2 per cent of GDP in the 1990s), stable and sustainable. Formal trade statistics indicate that increases in merchandise imports induced by trade liberalization have concentrated in raw materials, intermediate inputs, and capital goods. Despite popular claims to the contrary, the share of final consumption goods imports in total imports remained stable, at about 16-18 per cent (including food items), without showing any sustained surge. The following observations can be made with respect to the claim that domestic markets are 'flooded' with foreign goods as a result of trade liberalization:

The evidence does not show any widespread production displacement. Both the official statistics on production trends in manufacturing industries, as well as findings based on a survey of a sample of enterprises (World Bank Report No. 19591-BD 1999: Bangladesh — Trade Liberalization: Its Pace and Impacts) indicate that the majority of the manufacturing activities have continued expanding — albeit slower than expected. Not surprisingly, some enterprises in the import-competing manufacturing sub-sectors have suffered output and employment loss. The specific activities in which these firms are to be found include: cotton textile (mostly public sector mills and older mills in the private sector), vegetable oil, paper, insecticides, rubber footwear, metal products, and some machinery products. Despite long period of protection, a subset of enterprises in these activities appear to have failed in improving their efficiency and competitiveness. They are now feeling the pressures of competition brought on by trade liberalization and smuggling (which has nothing to do with trade liberalization).

High protection levels are encouraging significant levels of informal (unrecorded) imports, leaving the existing statutory protection levels partially ineffective, and causing substantial loss of customs revenues. Indeed, smuggled goods would have caused difficulties for some of the above cited import-competing activities even without trade liberalization, given that they are coming in 'duty/tax free'. Typically, enterprises in textiles, flour milling, vegetable oil, and salt end up having to compete with smuggled goods. Recent developments in formal (and informal) trade show a sizable trade deficit in favour of Bangladesh's largest import source, India. Proximity and competitiveness of Indian goods, Bangladesh's faster liberalization, as well as much larger depreciation of the Indian real exchange rate since the mid-1980s are among the factors that explain this outcome. Given that the overall external trade balances of Bangladesh are on a sustainable path, a large trade deficit with India is not, on its own, detrimental to Bangladesh. These deficits (or even larger amounts) would have been observed with other countries in any case, if not with India. Therefore, halting Bangladesh's broader trade liberalization or reversing it in response to India's slower liberalization would not be in the best interest of Bangladesh.

In a period of strong liberalization and globalization that has been sweeping most countries and markets (soon to include the textiles), linking Bangladesh's trade/industrial policies to those of India's would not be beneficial. India, having a vast domestic market, diverse resource base and much more diversified industrial sector, appears to have opted for slower trade liberalization.

Bangladesh, on the other hand, needs to rely on trade to a greater extent for sustained high economic growth. It needs to strengthen its export base to support such higher economic growth. A more neutral incentive regime with further reductions in the remaining anti-export bias would serve this objective better. In the circumstances, Sri Lanka, which has gone furthest in South Asia in trade liberalization in order to benefit its small economy from growing trade, is a more appropriate comparator than India in setting a path for Bangladesh's trade policy.

Has Trade Liberalization Improved Efficiency of Industries?

To examine the impact of trade liberalization in the 1990s on the industrial efficiency and productivity in Bangladesh, an empirical investigation was undertaken at the enterprise level using input, output, and cost data obtained from a sample survey. Data were collected for fiscal years 1992/93 (pre-liberalization) and 1997/98 (post-liberalization) for a sample of nearly 150 manufacturing enterprises giving the scope for measuring changes in technical efficiency and technological progress. The latter two factors in turn allow the measurement of changes in total factor productivity (TFP) of the surveyed firms.

Firstly, improvements in technical efficiency occur as firms reduce input wastage, increase capacity utilization, and exploit the available scale economies when markets open up with the removal of trade barriers making domestic markets more competitive. This implies that domestic firms are forced to reduce costs of production through improved management and input use. Trade liberalization could also trigger shifts in resources towards activities which become relatively more profitable as a result of tariff cuts and dismantling of QRs. By encouraging resource movements towards more profitable lines of production and more efficient firms, the removal of trade barriers could contribute to improvements in resource use in the economy and pave the way to production patterns more in line with the country's comparative advantage.

Secondly, an important channel through which the removal of trade barriers could benefit the economy is the increased availability of new technologies, new products, and ideas/knowledge about improved production processes, management, product designs, and quality. Trade liberalization generates gains in productivity through the employment of better and improved production techniques, through learning-by-doing, and increased opportunities for imitation/innovation. In short, freer trade could lead to productivity gains in the economy through technological progress, which make inputs more productive (higher TFP).

The evidence obtained from quantitative analysis suggests that during the trade liberalization period, export-oriented firms—not unexpectedly — did better in improving their technical efficiency while import competing firms have generally lagged behind in improving their relative efficiency in resource use.

Interviews with entrepreneurs revealed that firm specific problems and constraints imposed by an unfriendly business environment have been factors in slowing down efficiency improvements and adjustments to trade liberalization.

Majority of surveyed enterprises that are in production experienced positive total factor productivity change. Trade liberalization appears to have contributed to technological progress and enhanced productivity of inputs.

Some import-competing firms (e.g. in vegetable oil, paper, rubber/plastic, and metal works) appear to have been negatively affected from trade liberalization. This is also an expected outcome of trade liberalization: inefficient/high cost firms will suffer from increased foreign competition. However, it is important to highlight that many of the manufacturing firms surveyed listed other internal and external conditions — such as the cited constraints to doing business in Bangladesh — as factors that have adversely affected their performance.

One important implication of these findings is that faster improvements in the areas of infrastructure, financial sector reform, business support services, customs, and law and order, might have led to stronger benefits from the recent trade liberalization effort.

Conclusion

Many international economists who have looked at Bangladesh's trade performance in the 1990s have concluded that its trade liberalization since 1990 has been a textbook case of success. Exports have increased at double-digit rates, and imports have increased in parallel, leaving the trade balance largely unchanged — if not, improved — in dollar terms. These exports have been heavily concentrated in the garment industry, which is an industry well-suited to Bangladesh's comparative advantage in view of its heavy use of abundant unskilled labour. GDP growth has also accelerated — albeit modestly. What more could anyone ask for, apart from more of the same? And all of this happened despite the fact that Bangladesh's record in establishing an enabling business environment, reforming the financial sector, providing adequate power and telecommunications, and making ports function, leaves much to be desired. That the manufacturing sector did not take off and expected growth in investments did not take place had nothing to do with trade liberalization but everything to do with all of those factors that raised the costs of doing business in Bangladesh, and increased risks and reduced returns on investments.

Given the evidence, it is surprising that some of the critiques of trade reform in Bangladesh do not see things the same way. They have complained of a flood of imports having a devastating effect on the import-competing industries, and reducing the breadth of the country's industrial base. This is not even supported by the (deficient) Quantum Index of Industrial Production which shows a rising trend in the 1990s for the bulk of manufacturing, with the exception of some import-competing activities. Quite often, those who lose out (due to their own inefficiency) become vocal critiques of liberalization, leaving the impression that liberalization has been harmful — when it is not. There are even complaints that smuggled imports from India are taking markets away from local industry, with an apparent belief that smuggling is stimulated by trade liberalization (a notion so counter to all existing theory and the actual situation). What is seldom appreciated and little discussed is the fact that increased availability of cheaper and better quality goods under trade liberalization infused competitive efficiency in production and generated significant gains in the welfare of the vast majority of consumers, rich and poor, rural and urban alike.

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Will Taiwan's Pro-independence Leader Go along His Course?

'The election result will impact Taiwan's direction in the 21st century. In relations with China, the election result will influence the next step as in a game of chess."

by A.S. M. Nurunnabi

ONE of Taiwan's presidential candidates, Chen Shui-bian, vilified by China as radical who would thrust Taiwan towards independence and war, has won Taiwan's presidential election, trouncing the candidate of the party that has ruled the island for more than half a century.

Beijing deeply distrusts Chen because his Democratic Progressive Party favours taking Taiwan de facto to formal independence and making the 51-year-old split with China permanent.

However, the president-elect, who had softened his stance on independence to appeal to nervous voters, immediately after the voting results, pledged to seek dialogue with Beijing.

China's first response to Chen's win was that it would wait to see how the president-elect would handle relations. China has repeatedly threatened to wage war to block formal independence by Taiwan, which it has considered a renegade province since Chiang Kai-shek's Nationalists fled to the island. On his win, Chen assured tens of thousands of his supporters of his desire for peace with Beijing and declared," I hope we can use closer cooperation and exchanges and use patience and respect and together Chinese society can create a peaceful and happy new century."

In Washington US President Bill Clinton congratulated Chen and urged a renewal of dialogue between China and Taiwan that Beijing suspended in 1995.

It may be worthwhile to recall some important aspects of the past relations between China and Taiwan. Efforts to forge relations between Taiwan and China began with talks in Singapore in 1993. Follow-up high-level meeting planned in 1995 was broken off by Beijing accusing Taiwan government of drifting away from the common goal of reunification. Informal relations between the two countries, however, continued through contacts between Taiwan's Straits Exchange Foundation and China's Association for Relations Across the Straits.

Beijing has always insisted that formal talks begin with political discussions about reunification. On the other hand, Taiwan wanted" more cooperation" first starting with practical issues like fishing disputes. However, on a previous occasion, during his visit to China, US President Bill Clinton had pleased the Chinese by publicly endorsing the "Three Nos" in US relations with Taiwan: no recognition of "Two Chinas", nor of "One China, One Taiwan", and no support for Taiwan's membership in the United Nations or other organisations of sovereign states. That policy statement of the US President was a matter of great encouragement to China in pursuing the ultimate goal of reunification of Taiwan with the Chinese mainland.

It may also be recalled that two years ago, the present president-elect, Chen Shui-bian had no trouble getting re-elected as mayor of Taipei. Since his re-election as mayor of Taipei, there were speculations in many quarters that he might emerge as the strongest contender for the republic's top job for which election would be due two years from that time. That eventuality has now dawned with the election of Chen. An analyst observes. 'The election result will impact Taiwan's direction in the 21st century. In relations with China, the election result will influence the next step as in a game of chess."

The president-elect, Chen, insists that the people of Taiwan, unlike those of Hong Kong and Macau, should "have the final right to decide their own destiny. But he also accepts the need to negotiate with Beijing. The distinction may be subtle to an outsider. But since Chen has won, observers feel that there would definitely be a major difference of views for cross-country relations.

All the negotiations between the mainland and Taiwan were premised on the idea that both sides accepted the concept of there being just one China. The two sides didn't agree on what that "one China" was, but that ambiguity seemed to be intentional. The two states concept undermined the basis for future talks.

In the opinion of a keen observer, China may take a bit of time to digest the results, and then come out with a new policy initiatives or a policy adjustment. But mainland scholars are bracing for trouble in the period after the election and when the incumbent president Lee leaves office.

Beijing may start seeing time as being on its side, a shift from the sense it had in 1995 and 1996, when it carried out missile exercises near Taiwan to protest Lee Teng-hui's 1995 trip to the US. As economic ties between the mainland and Taiwan continue to increase, that is seen as a favourable factor. The long-term impact of military modernization in probably seen as a positive factor to. But as a knowledgeable US analyst warns, in militarizing the conflict with Taiwan, China increases the danger of the US getting involved, and involved in a military sense. US politicians watch China's military posturing far more closely now than in the past. What China sees as a rational effort to increase pressure on Taiwan to come to the bargaining table, people in the US see as an aggressive, threatening act, not just demonstrating Chinese hostile intentions towards Taiwan, but also may be saying that China is a threat to regional security.

Many American observers worry that if Taiwan's new president-elect goes along on its course for independence, it could draw the US into another conflict with China. The US has been committed to the one-China policy for well over 50 years. The danger is that the US could incrementally get sucked into a conflict.

Workers Find Their Voice Again and Demand Greater Say

As Russia prepared to vote on a successor to Boris Yeltsin (who resigned as President on new year's eve) there has been signs of a revival of organised labour — whose voice was hardly heard throughout the social trauma and industrial collapse of the mid-1990s.

Simon Pirani writes from Moscow

ANTON Parkansky, the newly appointed director of the Moskhimfarm pharmaceuticals factory in Moscow, brought an armed escort when he arrived to start work early one February morning. The workers, who had occupied the state-owned plant and had already barred him from entering twice, were ready once again.

He faced 100 pickets. A scuffle broke out and a woman worker's arm was broken. Parkansky, 31, a manager employed by a private medicines company, backed off and said he would not return to the factory.

"The workers were against his appointment," explained Yelena Vorobyova, of the plant's trade union committee. "The factory was occupied for two weeks."

Parkansky's company, Vremya, had helped to privatise — and cut the workforce of — two other pharmaceuticals factories. The Moskhimfarm workers feared that they would be next. Now, they will be keeping a sharp eye on Mikhail Grigoriev, appointed by the economy ministry to replace Parkansky.

Their case is symptomatic of a trend. Russian workers are campaigning not only against long delays in paying wages, but also for a greater say in how their workplaces are run.

Plans to privatise factories, and the arrival of owners that workers do not trust, have sparked a series of conflicts. At the Chernigovsky open-cast mine in Kemerovo, Siberia, workers locked out the new owners, declared a "people's enterprise" and clashed with riot police. A similar showdown occurred at the Lomonosov porcelain factory in St Petersburg.

The most significant battle was prompted by the privatisation in 1997 of the Vyborg cellulose plant — between St Petersburg and the Finnish border — on which the village of Sovetsky depends for its livelihood.

The factory was sold to a vodka entrepreneur, Aleksandr Sabadash, for an estimated half of one per cent of its real worth — a move not uncommon in post-Soviet Russia, where many state assets have been grossly undervalued for sale.

At first the workers did not react, even when wages went unpaid. But when Sabadash tried to replace local security guards with his own special force, triggering a rumour that he was about to lay off two-thirds of the 2,000 employees, they occupied the factory, declared it "common property" and elected their own director.

The factory soon found customers for its products, and for 18 months worked as a co-operative. Everyone received a monthly wage of 1,500 roubles — high by Russian standards. A programme of social support for the village was organised : free milk and electricity, free hairdressing and holidays for children, and financial help for pensioners.

Then, last October, the factory was raided by armed police and private security guards, trying to regain control of it for Sabadash. Two workers were wounded in a shoot-out. But the cooperative held out.

Legal challenges and negotiations followed. In January, a Sabadash company sold the factory to a British firm, Alcem. One of the cooperative leaders, Vitali Kiriakov, signed a deal with Alcem surrendering control in exchange for guarantees of pay rises, social benefits for the village and no redundancies.

Aleksandr Buzgalin, a Moscow economics professor who has collaborated with the labour movement since the late Eighties, said the Vyborg workers had taken matters into their own hands. "They tried to maintain and expand production, find buyers for their products and pay suppliers on time," he said.

In general, Buzgalin pointed out : "There are many problems with ownership disputes. Sometimes two groups of businessmen, or gangsters, are trying to gain control of a workplace and the workers find themselves being manipulated."

Industrial stands such as those at Moskhimfarm and Vyborg could help foster a general revival of organised labour, say union activists. Workers are again finding their voice

— in a new Russian era marked by the resignation of President Boris Yeltsin and selection of a successor in an election on 26 March.

An independent workers' movement began to stir in 1989-91 as the legal right to strike and organise was re-established. But, by the mid-Nineties, it had been suppressed by the shock of hyperinflation and industrial collapse on one side, and inexperience and corruption in its own organisations on the other.

Now, a new generation of workers is pressing for a better deal — often coming up against a new, brash breed of employer.

Kirill Buketov, who runs the Moscow office of the international foodworkers' federation, IUF, said : "The first wave of privatisation in the early Nineties was the theft of state property by those who already controlled it.

"But now, besides the multi-millionaire oligarchs who built their financial empires at that time, there are smaller financial groups with large sums to spend on buying businesses. Sabadash, who wanted to rise from the vodka business to something more solid, is typical."

At a McDonald's food plant, where products are prepared for the company's Russian restaurants, attempts by management to discourage union membership have been defied with a stubbornness that Buketov has found "staggering."

He said: "The union members there are mostly in their early or mid-twenties. They had no previous trade union experience. They joined the union and started making demands, which shook up the union as well as McDonald's."

Buketov, who in 1990 helped to found one of Russia's first workers' support groups, the Kas-kor information centre, said: "When we started, under (former Soviet president Mikhail]) Gorbachev, no-one knew what a proper trade union was.

"We had to learn," added Buketov, now 30. "The new generation is learning much faster than we did."

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