Trade policy for the 21st century

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OVER the past two decades, Bangladesh converted its trade policy regime from a near-autarkic one during the 1970s and 1980s to a progressively more open regime. The policy reforms have been focused and comprehensive involving a dismantling of most quantitative trade restrictions and sharp reductions in custom duties. This has served Bangladesh well. Merchandise trade (exports plus imports) to GDP ratio has expanded from 21 percent in FY1992 to 52 percent in FY2012. Exports have grown from a mere $2.6 billion in FY1992 to $24.3 billion in FY2012, attaining a heady pace of growth of 12 percent per year. The readymade garment sector, which has been the leader in the exports boom, alone has created 3.6 million jobs, accounting for almost 60 percent of total manufacturing employment. Overall, the expansion of exports has contributed substantially to GDP growth, employment and poverty reduction.

The supportive role of trade policy in promoting exports can be seen not only from a simple correlation between the removal of trade barriers and growth of exports but much more convincingly from the experience of the garment sector. There is a misperception that apparel exports boomed owing to the multifibre agreement (MFA) of 1974 that allowed foreign investors to take advantage of the quota space allocated to Bangladesh. While the MFA indeed created the initial space, subsequent growth in garment was facilitated by a number of important factors of which the bonded warehouse system that allowed duty-free imports of raw materials played a critical role. By allowing access to world prices for both inputs and outputs, the trade policy provided a huge impetus to garment exports. At the same time, by dismantling many of the instruments of trade protection to inefficient domestic production trade policy helped lower the disincentive for exports.

There was a fear that the phasing away of the MFA in 2005 will hurt garment exports. Events have proven the prophets of doom wrong. Contrary to their predictions, the Bangladeshi garments gained additional market share after the MFA phase-out owing to the inherent accumulated strength of the sector based on productivity and cost advantages. Indeed, with cost escalation in China and India owing to growing labour cost, the prospect for Bangladesh in gaining additional market share of global garment is bright. To take advantage of this prospect Bangladesh will need to take swift and firm actions to remove some of the emerging constraints, especially the globally explosive issue of worker safety at the workplace.

One important question is if trade policy supported the growth of garments, why is this positive experience not seen in the case of other exports? There are two major reasons for this. First, the full benefits of the trade policy liberalisation and its implementation through the bonded warehouse system are not available to most other exports. It is true that custom duties and other import levies are generally low for capital machineries and raw materials and there is also a duty draw-back system, but actual implementation leaves a substantial gap in terms of time and transaction costs (unlike the benefits of a bonded warehouse system). Additionally, the back-to-back LC system for garment inputs and outputs is also not available to most other exports.

A second very important factor is that trade policy is only one element of support for exports. Other determinants include labour skills, technology, foreign investment and skilled entrepreneurs. A critical factor for the success of garment is the ability of this sector to attract a large number of skilled and talented entrepreneurs who in turn have invested significantly on in-house training of the labour force. Indeed the cost advantage of the apparel sector emerges from the fact that it has very successfully tapped the hugely abundant and low-cost women labour force into an asset by providing them in-house all the training needed for production. This innovative in-house labour training is not a universal phenomenon in Bangladesh. The role of foreign direct investment is another positive feature that has contributed to the growth of the apparel sector by transferring technology and know-how from the international marketplace.

Notwithstanding its positive contribution to development, trade policy has come under stress in the past few years. The main pressure has come from the fiscal side. Inadequacy of tax revenues, mainly from income and wealth sources, has caused the government to go back on some of the tariff reductions with the introduction of supplementary duties or para tariffs. This reversal of trade policy reforms is mostly unintentional. The primary motive is revenue collection rather than trade protection based on strategic considerations. Nevertheless, the signal to investors is worrisome. The complex system of supplementary duties has resulted in an arbitrary regime of trade protection that imparts a substantial anti-export bias.

Between FY1992 and FY2009 the average custom duty has come down sharply from 71 percent to 15 percent (it was 100 percent in 1985). This has also lowered the average nominal rate of protection (NPR), down from 74 percent in FY1992 to 20 percent in FY2009. However, the NPR has started rising since then, reaching 27 percent in FY2012, due to the growing influence of para-tariffs, such as supplementary and regulatory duties. Indeed, the para tariffs now account for 48 percent of the NPR, as compared with only 3 percent in FY1992, suggesting that they have become a huge countervailing force to the reform of custom duties. There is also a growing wedge between output and input tariffs resulting in higher effective protection (ERP) for domestic producers at a cost to exporters who face anti-export bias in export expansion and diversification.

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The hugely abundant and low-cost women labour force in the garment sector has turned into an asset.

YUNUS CENTRE

Nepalese President Ram Baran Yadav receives Nobel Laureate Professor Muhammad Yunus at Rashtrapati Bhavan in Nepal on Friday.

Yunus launches social business in Nepal

STAR BUSINESS DESK

NOBEL Laureate Muhammad Yunus is now in Nepal to attend a series of high-level meetings on social business and microfinance organised by the Confederation of Nepalese Industries (CNI).

On the first day of his three-day visit on Friday, Prof Yunus addressed a national-level summit of microfinance practitioners in Nepal, attended by 300 participants and organised by the Reserve Bank of Nepal, CNI and Rural Microfinance Development Centre.

"We are grateful to you Professor Yunus for innovating such a modern form of technology for poverty alleviation as microfinance," said Nepalese Prime Minister Baburam Bhattarai, who is also the vice chairperson of the Unified Communist Party of Nepal (Maoist) and the chief guest of the summit.

"It has proven to be a major tool for poverty alleviation, and has made millions of poor families to upgrade their economic status in the society. Nepal followed this path since 1992."

There are currently 130 organisations in Nepal that are undertaking microcredit, reaching more than 1.8 million families. Most of the organisations follow the Grameen system with support from Grameen Trust.

Bhattarai also thanked the Nobel laureate for his innovative concept of social business as an effective way to tackle social problems, and said he would like to come to Bangladesh as a student to learn about social business.

Yunus recommended taking microcredit to the next level in Nepal by broadening the work by using social business as a tool to solve social problems.

He stressed particularly the role of citizens' especially young people in championing social business.

"Making money is happiness, but making other people happy is a super happiness."

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Central bankers rethink their devotion to slaying inflation

REUTERS, *New York*

A subtle shift in monetary policymaking is afoot with a new generation of central bankers, striving to secure global economic recovery, prepared to challenge the old doctrine of inflation-fighting at all costs.

Mark Carney, the governor of the Bank of Canada and soon-to-be head of the Bank of England, may or may not have intended to spark a high-level debate last week over how diligently central banks should fend off inflation.

But he did just that with his speech in Toronto on the BoC's flexible approach to prices, and his musings on alternative approaches to policy that the Canadian central bank had considered but dismissed.

Within two days, Britain's finance minister, two BoE policymakers, and numerous economists had weighed in on what Carney's comments meant for the country and for the future of central banking.

The sharp reaction reflects unease with a change in the way the world's major central banks approach policy in an era of slow recovery from world economic crisis.

Policymakers from the US Federal Reserve to the Bank of Japan have reconsidered or relaxed their inflation targets -- long the raison d'etre of monetary policy -- and have given more emphasis to economic growth, even if that is not an official mandate.

"They have reduced their slavish devotion to the sole goal of inflation targeting," said Carl Tannenbaum, a former Fed official who is now chief economist at U.S. asset manager Northern Trust.

No central banker is going to tolerate an inflation spike in order to boost employment or foster more growth.

Policymakers have also largely dismissed some of the more radical alternatives to achieving their goals, most notably targeting levels of nominal gross domestic product (real GDP plus inflation).

Yet with the financial crisis having starkly exposed central banks' failure to stave off danger, and policymakers having responded by flooding world markets with trillions of dollars in cheap funding, a small run-up in inflation may no longer be the anathema it once was.

In the world's largest economy, Fed Chairman Ben Bernanke has unleashed some $2.5 trillion in asset purchases in the last few years to boost hiring and economic growth, squarely focusing on the employment side of the US central bank's dual mandate.

His approach differs to that of his veteran predecessor Alan Greenspan. The same goes for Mario Draghi who took over from Jean-Claude Trichet at the ECB and it looks like Carney, replacing Britain's Mervyn King, fits the same pattern.

The Fed last week tied low interest rates to a drop in the jobless rate to 6.5 percent -- it stood at 7.7 percent last month -- as long as inflation did not threaten to top 2.5 percent.

The unprecedented move may represent the culmination of its departure from the inflation-centric model pursued by former Fed chairmen Greenspan and Paul Volcker and gave a clear signal that it would tolerate inflation above its 2 percent target if that was the cost of getting more Americans back to work.

Eric Green of TD Securities, a former New York Fed economist, wrote that "Bernanke has relaxed the inflation constraint", effectively raising the Fed's core inflation target over time from 1.75 percent to 2.5 percent.

North of the border, the Bank of Canada has long had an inflation target of 2 percent within a range of 1 to 3 percent.

But unlike past BoC governors, Carney, 47, has emphasised the idea of "flexible targeting" in which inflation could be allowed to stray from the target for longer than would normally be tolerated in order to stabilise financial markets or the economy.

Carney said earlier this month that the BoC explored the idea of changing its inflation targeting mandate altogether but decided that was too risky.

He stressed he was not dropping hints about his plans for Britain yet BoE policymakers were quick to push back on any notion the country should change its approach to policy.

Paul Fisher, the BoE's executive director for markets, said Britain should be wary of changing the central bank's 2-percent inflation target and had no need to adopt the longer-term commitments its North American counterparts have made on interest rates.

REUTERS

Bank of Canada Governor Mark Carney views some historic gold coins dating back to before World War I, at the Royal Canadian Mint in Ottawa on November 28.