

Trade protection and job creation

SADIQ AHMED

THE global debate over trade protection has gained momentum in the aftermath of the US national elections where populist candidate Donald Trump won the presidential elections promising the use of trade protection to create jobs. Although the case for free trade is contentious at both the theoretical and the empirical level, there is a broad agreement that large trade protection, unless offset by strong dynamic production gains from the protected industries, tends to lower national welfare by taxing consumers and reducing potential gains from production efficiency and expansion of export industries. In the case of Bangladesh, evidence shows that large trade protection from the early days of independence did not benefit industrial development and growth. Instead, trade liberalisation from 1980-2000 along with investment deregulation and better macroeconomic management boosted private investment, exports, manufacturing and GDP growth.

Trade policy reforms have taken a back seat since the early 2000s and nominal protection rate remains large. Even as customs duties have come down, the protection effects have been preserved by the introduction of a large range of supplementary duties (SD) and regulatory duties (RD). Indeed, these para-tariffs (SDs and RDs) now account for almost 50 percent of the nominal protection. The protection effects in many instances are unintended. The primary motive for the para tariff is revenue generation and these are imposed by the National Board of Revenue (NBR) without consultation with the commerce ministry who has the institutional responsibility for trade policy. The para tariffs are reviewed every year and changed as per the needs of revenue generation mainly without regards to the implications for trade protection and resource allocation,

with few exceptions.

This randomness of the para-tariff regime is further illustrated by the examples of effective rates of protection (ERP) that were calculated based on a sample survey of 200 manufacturing enterprises in 2012. The ERP rates ranged from zero for export products to 483 percent for certain type of plastic products. There is wide dispersion in ERPs by sub-sectors and within sub-sectors. The large range of ERPs reflects the ad-hoc nature of the trade regime as far as incentives for production are concerned. What is clear, however, is that these ERPs provide a serious anti-export bias.

Despite the lack of evidence in support of trade protection, it continues to persist. What explains this persistence? Apart from the political economy aspects, the most used argument is that trade protection supports domestic workers by protecting their jobs from import competition. There are two problems with this argument. First, trade protection may support job creation in the protected sectors but it creates a serious anti-export bias that hurts job creation in the export industries. Second, on balance, what is the evidence that trade protection creates jobs faster than through a neutral trade regime that does not discriminate against export industries?

This article seeks to provide some insight into this debate by using available employment data from the various labour force surveys (1985 to 2015-16), the Survey of Manufacturing Industries 2012 and the BCGMEA database on garment employment. The available data is grouped into three categories: total manufacturing employment; employment in manufactured export industries and employment in domestic-demand oriented manufacturing enterprises. The summary of the research is reported in the graph.

The results are very striking. In the mid-1980s, before the advent of the apparel revolution, the manufacturing sector was small, accounting for



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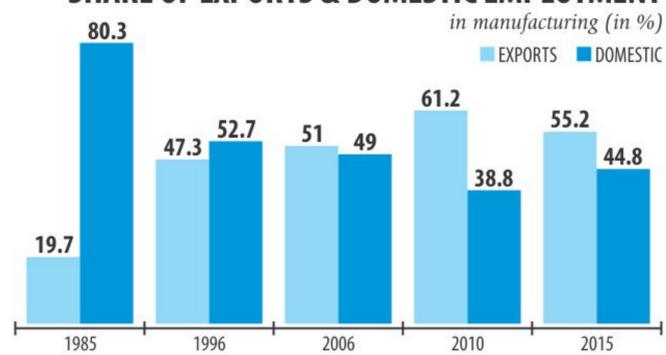
11 percent of GDP and creating only 2.3 million jobs. The bulk of manufacturing employment (80 percent) was in domestic demand oriented manufacturing enterprises. Exports were negligible and created few jobs.

The trade and investment deregulation reforms of the 1980-2000 periods sharply changed the picture. Private investment and the apparel revolution took charge. By 2006 the GDP share of manufacturing had grown to 15 percent, boosted mainly by garment exports. Apparel was the dynamic source of employment, creating some 2.1 million new jobs between 1985 and 2006 as compared with 0.7 million additional jobs in the domestic demand oriented manufacturing enterprises. Combined with other export-oriented manufacturing enterprises, the share of manufactured export jobs increased dramatically from a mere 20 percent in 1985 to 51 percent in 2006.

This progress with contribution to value-added and job creation intensified further and by 2010, the export sectors accounted for an estimated 61 percent of total manufacturing jobs in Bangladesh. The share of domestic demand oriented manufacturing enterprises dwindled to 39 percent in 2010 as compared with 80 percent in 1985. The debacle it faced in job creation as compared with the export-oriented apparel sector is obvious.

More recently, the garment sector is facing some structural challenges as well as slowdown in global demand that has hurt its growth prospects. Compliance with employment and safety standards has caused greater capital intensity and closure of many garment enterprises. Together these have taken a toll on apparel employment that has remained unchanged at around 4 million since 2013. The anti-export bias of trade policy and the sharp appreciation of the taka in

SHARE OF EXPORTS & DOMESTIC EMPLOYMENT



real terms against all major currencies including the US dollar, the euro and the Indian rupee have combined to hurt the export industries in general.

Some of the employment slack has been taken up by domestic-demand oriented enterprises. As a result, the employment share of domestic-demand oriented manufacturing enterprises has grown in the recent years, up from 39 percent to 45 percent. But this is more due to the stagnation of apparel employment growth rather than any evidence of growing dynamism of the domestic-demand oriented sector. Overall, even after allowing for the recent stagnation in apparel employment, the long-term employment growth in export-oriented manufacturing between 1991 and 2015 has been 7.1 percent per year as compared with only 2.2 percent in domestic-demand-oriented manufacturing.

The reason for this is pretty straight forward and in accordance with modern trade theory of comparative advantage as expounded by Nobel-prize winning economist Bertil Ohlin and his teacher Eli Heckscher (known as the Heckscher-Ohlin theorem). According to the Heckscher-Ohlin theorem, a country will export commodities that use relatively more intensively its abundant factor of production and import

those commodities that use the relatively scarce factor. It is well known that Bangladesh has abundant labour supply but capital is scarce. Hence by concentrating on exports, it has succeeded in creating more jobs in export-oriented manufacturing (mainly apparel) than the import substitutes that are relatively more capital intensive.

The way forward for job creation strategy is obvious. Policy should focus much more on promoting export-oriented manufacturing by correcting the anti-export bias of trade policy and by eliminating the appreciation of the real exchange rate. Other policies concern the need to reduce the cost of production by reducing the cost of doing business, improving infrastructure and addressing the land constraint. But they apply equally to both export and domestic-oriented production. These reforms will help diversify the export base and boost other non-apparel exports such as leather, footwear, processed foods and electronics. Growth of these exports will create jobs at a much faster pace than domestic-demand oriented enterprises.

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IMF raises China 2017 growth forecast again



A delivery worker unloads packages on a street in Beijing.

REUTERS, Beijing

THE International Monetary Fund on Wednesday raised its forecast for China's 2017 economic growth to 6.7 percent, its third increase this year, citing "policy support, especially expansionary credit and public investment". In April, the IMF hiked its forecast for this year to 6.6 percent from January's 6.5 percent, which was 0.3 percentage points above the previous projection. China's economy grew a faster-than-expected 6.9 percent in 2017's first quarter, well above the government's target of around 6.5 percent for the full year. The IMF said it now expects China's growth to average 6.4 percent annually during 2018-2020. In April, the fund said it expected 2018 growth to be 6.2 percent. Along with a higher growth forecast, the IMF on Wednesday recommended China speed up reforms to transition its economy to more sustainable growth and adopt less accommodative monetary policy.

"The critically important recent focus on tackling financial sector risks should continue, even if it entails some financial tensions and slower growth," IMF deputy managing director David Lipton told reporters in Beijing.

China needs to ensure that "where credit is granted, it is backing economic activity that will be useful, that will be supportive of growth and will permit debts to be serviced without difficulty," he said. Beijing should also resume progress towards a flexible exchange rate, Lipton said, while adding that the IMF assesses the yuan currency to be "broadly in line with fundamentals".

The strengthening U.S. economy, albeit with normalizing interest rates, is likely to be useful for the rest of the world, Lipton said.

The IMF official said President Xi Jinping's speech at Davos in January was the start of China playing "a kind of leadership role at a time when there is a dialogue going on around the world about the path of globalization."

Google seals deal with Indonesia on tax

APP, Jakarta

Indonesia has reached an agreement with Google over payment of taxes, the country's finance minister said Tuesday, after a long-running dispute with the US tech giant.

The two sides have been locked in a row since last year when the government alleged that the California-based company had refused to cooperate with its tax office. A senior tax official had claimed the

company had not fulfilled its obligations and owed over \$400 million in taxes and fines for 2015 alone. Google insisted it had paid all taxes due in Indonesia since opening its Jakarta office in 2011.

Finance Minister Sri Mulyani Indrawati told reporters Tuesday that "we had a discussion with them (Google) and reached an agreement based on the 2016 tax report, but because it is confidential we don't disclose the amount".

In Pakistan, China presses built-in advantage for Silk Road contracts

REUTERS, Islamabad

LAST year, Pakistan held informal talks with General Electric, Siemens and Switzerland's ABB to build the country's first high-voltage transmission line. Chinese power giant State Grid committed to building the \$1.7 billion project in half the time of its European counterparts – and clinched the deal. This is a familiar tale in Pakistan and many other countries.

As China makes its "Belt and Road" initiative – a massive project to connect Asia with Africa and Europe through land and maritime routes – a policy priority for the next decade, Chinese companies are taking the lion's share of infrastructure projects across the region.

Just last year, Chinese firms won project contracts in Belt and Road countries worth \$126 billion, state media reported.

In Pakistan, whose geographical position makes it central to Beijing's "Silk Road" plans, contracts have been awarded for projects worth more than \$28 billion – all by Chinese companies working together with local firms. More than \$20 billion in new investment is likely in the next few years, Pakistan's Planning Minister Ahsan Iqbal told Reuters this week.

Last month, Pakistan's government took out full-page newspaper advertisements on the first China-Pakistan project completed under the plan, a 1,300 mw coal plant that it said was constructed in 22 months, a record time for such a facility. The plant is owned by China's state-owned Huaneng Shandong and the Shandong Ruyi Science & Technology Group.

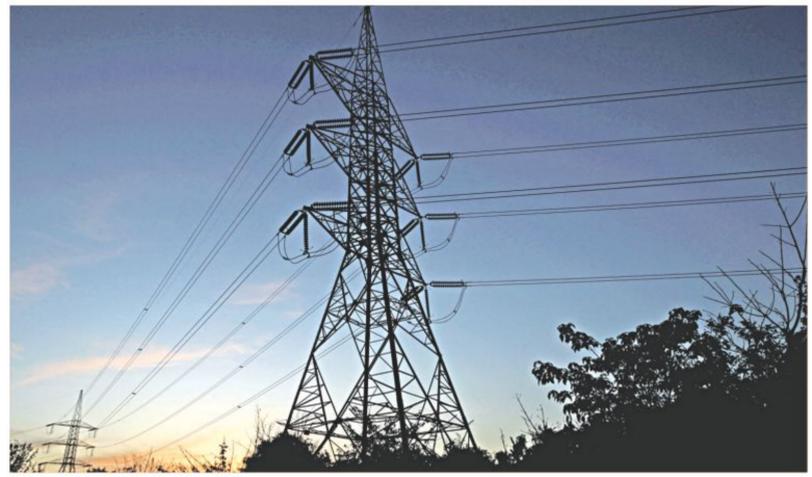
China Inc's main advantage, officials in both countries said, is the ability of Chinese banks – with the blessing of the government – to fast-track loans for projects related to the Silk Road. That makes a huge difference to projects like Pakistan's power transmission line, which aims to end regular energy cuts that leave the country's 190 million population without electricity for several hours every day.

"(Chinese companies have) that advantage because of the support of the Chinese government," said Mohammad Younus Dagha, a senior government official who was in charge at the Water and Power Ministry until earlier this year.

Dagha, who spoke to Reuters shortly before being transferred to the Commerce Ministry, said Beijing was fast-tracking loan approvals and pushing its banks and insurance firms to speed up due diligence work.

Chinese government officials declined comment on specific loan approvals.

But two officials at two Chinese state-owned banks that direct government funding, China Development Bank (CDB) and Export-Import Bank of China (EXIM), told Reuters that they have been instructed by the government to favor lending to Chinese firms for Silk Road



Power transmission towers are seen on the outskirts of Islamabad, Pakistan.

REUTERS

projects.

The officials also said that the two banks prefer that companies working on infrastructure projects across the region import raw materials or purchase equipment from China.

There is some criticism in Pakistan that the awarding of the contracts to Chinese companies – while speeding up projects – is also costing the country more money.

In the transmission line project deal, for example, General Electric estimated it could make one key part of the line – the converter stations – for about 25 percent less than what State Grid was charging, according to a Pakistani government official and two power sources familiar with GE's projections. By awarding the contract to State Grid, Islamabad paid a higher price, they said.

An official at Nepra, Pakistan's independent energy regulator, said State Grid was also given a tax break not on offer to other investors.

Pakistani government officials declined to comment on tax issues regarding the deal. China Electric Power Technologies Company Limited (CET), the State Grid subsidiary that will build the line, said the price it asked for was fair. "It's a very reasonable cost," said Fiaz Ahmad Chaudhry, managing director of Pakistan's National Transmission & Despatch Company (NTDC) referring to the overall State Grid contract.

Chinese Foreign Ministry spokeswoman Hua Chunying said the process for Belt and Road projects in Pakistan was "open and transparent" and would bolster bilateral relations and regional prosperity.

The edge of Chinese companies in Pakistan is likely to continue. Under the Silk Road plan, China and Pakistan are planning to build \$57

billion worth of power plants, port facilities, railway lines and roads in Pakistan.

During a meeting in Beijing last month, Chinese President Xi Jinping said that the plan would be accelerated.

The transmission line project was conceived as a government-to-government contract to build a 878-km (545-mile) connection between soon-to-be-built power plants near the coastal town of Matiari and Pakistan's industrial heartland by the eastern city of Lahore.

According to Pakistani officials, no formal competitive bidding was sought for the project, which was finally awarded in December last year. But the officials said GE, Siemens and ABB were contacted when initial talks with State Grid stalled around mid-2016 over costs.

Dagha told Reuters he briefly met officials from the three companies on the sidelines of a Paris power conference in August and informally talked about the transmission line contract with them. GE made an initial cost estimate of \$800 million for the converter stations, against State Grid's initial bid of \$1.26 billion, according to documents from Nepra and sources familiar with GE's cost estimate. Despite the lower cost, the problem for Prime Minister Nawaz Sharif's government was speed. Sharif has staked his political credibility on ending Pakistan's frequent power blackouts before the next general election are held by August 2018.

So, Dagha said he asked the Western companies to also match State Grid's ambitious timeline and wrap up work in 27 months.

"They said 'you must be joking...it's impossible'," Dagha recalled. Dagha said Western executives predicted it would take at least 48 months to build the line.