The costs of industrial protection: who pays?

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GHOSTS OF PROTECTION

Protection to domestic industries has been an integral part of Bangladesh's economic policy since independence. This was one policy we inherited from Pakistan times without much thinking. In the 1970s there emerged an alternative path to industrialisation and growth – export-oriented industrialisation.

Success of the East Asian economies—South Korea, Taiwan, Hong Kong, Singapore—showed the way. China is an extraordinary example having achieved double digit GDP growth rates for a quarter century on the back of exports. Bangladesh finally moved to embrace the policy of export-orientation and trade openness, albeit gradually and intermittently over the past 30 years or so.

A closer review of the state of industrial protection as it stands today reveals that the ghosts of protection remain alive and kicking, imposing costs on the economy and consumers, in particular. It is the premise of this brief analysis that the burden of protection costs falls unevenly on the consumers in Bangladesh, through high tariff-induced prices of imported consumer goods and import substitutes domestically produced and sold.

THE SURGING MIDDLE CLASS

With Bangladesh's middle class surging in size and spending power consumer goods are in high demand – but at what price? In 2015, a leading international firm, Boston Consultancy Group (BCG), published a report entitled, "Bangladesh: The Surging Consumer Market Nobody Saw Coming."

The report focused particularly on the middle and affluent class (MAC) in Bangladesh, defined as consumers earning more than $401 (approximately Tk 34,000) a month, or above $5,000 annually. This segment of consumers, estimated to be around 12 million strong, provided insights into the consumption trends of goods and services that went beyond basic necessities, and into the realm of convenience and luxury.

Examples include air conditioners; flat-screen TVs; and imported cosmetics. BCG projects the size of Bangladesh's MAC population to rise to 34 million by 2025, when our GDP will have crossed $500 billion.

The BCG report points out that the Bangladesh MAC population accounts for only 7 percent of the country's population—meager by Asian standards. In comparison, the number stands at 21 percent for Vietnam, 38 percent for Indonesia and 59 percent for Thailand.

Since Bangladeshi consumers pay around 50 percent to 100 percent above world prices for consumer products—either imported or produced locally—this does not seem all too surprising. Why?

BANGLADESHI CONSUMERS PAY HIGH TARIFF-INDUCED PRICES

Consumer Association of Bangladesh (CAB) is now voicing concern that consumers are being left out of budget consultations and any discussion on tariff setting, though they are the ones who ultimately bear the burden of the tariffs. Even on a global scale, Bangladeshi consumers face the highest average rate of tariffs on imports, especially compared to its Asean neighbours, all of whom impose substantially lower average tariffs (e.g. Bangladesh 25.6, Vietnam 9.6, Thailand 10.2, Asean 4.7).

Since tariff rates on consumer goods are typically higher than average rates, Bangladeshi consumers pay some of the highest prices for consumer goods in Asia, if not the world.

MEASURING COSTS OF PROTECTION

Bangladesh tariff protection structure presents a unique case where much of the protection is accorded to producers of import substitute consumer goods. This presents a unique but simple approach to measuring the costs of protection to consumers by measuring the divergence between the international price and the tariff-induced domestic price of protected consumer goods.

A tariff raises the domestic price of the product over the international price by at least the amount of the tariff. As such, it is in essence a tax on the consumer and a subsidy to the producer; in the sense that without it the producer would have to sell at the international price, which is lower. Producers pass on the tax burden to consumers in the form of higher tariff-induced prices including mark up.

Moreover, the higher tariff-ridden prices contribute to restraining imports, and limiting the consumers' choice. PRI research has monitored trends in nominal tariffs and landed cost of imports for over 25 years in order to be able to measure the extra cost to consumers as a consequence of protective tariffs on consumer goods.

Consumers do not just pay a higher price for the imports, but also have to pay an extra cost in the form of higher prices on domestically produced import substitutes, as producers potentially raise prices up to the tariff-induced price.

Estimations of the extra cost borne by consumers due to protective tariffs can then be computed by adding up the protection-induced price effect (NPR) – extra cost – on the sum of imports and domestically produced import substitutes.

These costs are then propounded as a proportion of GDP.

The estimate of the protection cost is based on the importation of consumer goods and domestic production and sale of import substitute consumer goods only, excluding automobiles, alcoholic beverages, cigarettes, and firearms.

During the 5-year period, FY2013-17, the total protection cost to consumers works out to a substantial amount of $70.6 billion. For the fiscal year 2017, the protection cost to consumers works out to $14.2 billion (Tk 120,000 crore), or 5.7 percent of FY17 GDP, and 31 percent of manufacturing value added.

EXTRA PAYMENT ON IMPORTS AND IMPORT SUBSTITUTES BY CONSUMERS DUE TO PROTECTION

Fiscal Year	NPR (%)	Domestic production /sales of import substitutes	Import value	Protection cost from import substitutes	Protection cost on imports	Total protection cost to consumers
FY2012	46.30	21,882.5	4,224	11,817	954	12,771
FY2013	47.09	23,408.2	3,777	12,721	823	13,544
FY2014	44.50	26,092.7	4,623	13,386	914	14,300
FY2015	43.15	25,932.7	6,042	13,047	1,155	14,202
FY2016	41.84	27,455.5	5,936	12,973	1,337	14,310
FY2017	41.07	26,861.0	7,546	12,644	1,579	14,223

Source: **ASYCUDA database, and PRI staff estimates. Figures in million US$**

Notes: NPR = nominal protection rate

This is in essence the extra cost consumers pay over international prices – a veritable transfer of resources from the pocket of consumers to that of producers.

On average consumers paid 70 percent above international prices for buying consumer goods in the domestic market.

NPR is a reasonably good estimate of the price raising effect of tariffs and para-tariffs (i.e. protective effect of customs duty and other trade taxes).

In Bangladesh, research shows that the majority of all domestically produced manufactured products are subject to the highest NPR rate. At present, the consumer products with the highest rate of NPR include air conditioners (156 percent), plastic tableware and kitchenware (113.44 percent), non-leather footwear (113.44 percent), sanitary wares (104.80 percent), etc. – products that have been integral in fuelling the rapid expansion of the brand-savvy MAC population.

CONSUMERS FAIL TO LOBBY

Evidently, when it comes to tariffs, the consumer seems to have no voice. Amidst a plethora of stakeholder consultations pre- and post-budget organised by the chamber representatives round the year, producers put forth various proposals for tariff adjustments, understandably, to raise their profitability which can happen if output tariffs are raised or input tariffs are cut.

Producer groups, of whom there are many, lobby hard to get input tariffs (on intermediate, capital, and raw materials) reduced and output tariffs (on consumer goods) increased as much as possible.

To the extent that producers get their way – and it seems they do – the outcome is skewed in favour of producer interests and against consumer interests as consumers end up paying prices that are significantly above international prices.

This is essentially a protection tax on consumers. But nobody, not even the Consumer Association of Bangladesh (CAB), has raised the issue of how long should consumers continue to be taxed to protect producers. This situation is quite unique for Bangladesh but any discussion is absent from the policy discourse.

RATIONALISING PROTECTION A NATIONAL IMPERATIVE

The strategy of import substitute protection for industrialisation comes at a high price in Bangladesh, paid by consumers who end up bearing the brunt of the protection tax. This could only make sense if it were a time-bound initiative. But theory and practice tells us that that is not how protection works. Once started it takes a life of its own. Besides, import substitution has not given us jobs and growth. Export orientation has. RMG success is not a story of import substitution transiting into exports; it started off as an export industry. Not only is the economy stuck in the quagmire of high protection this policy is also characterised with anti-export bias which is preventing numerous non-RMG exports (some 1400 products in FY2017) from becoming significant export items, thus hampering product diversification of exports.

Amidst the ever-growing demand for consumption, rationalising the protection regime has become a national imperative that can spur domestic spending to fuel growth. It is time for CAB to become proactive on the issue of protection costs, thus going beyond those of ensuring unadulterated foodstuff or proper product labelling.

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Trump denies planning to pull out of WTO

AFP, *Washington*

PRESIDENT Donald Trump denied Friday he is planning to withdraw the United States from the World Trade Organisation.

"I'm not talking about pulling out," he told reporters on Air Force One when asked about reports he was planning an exit from the global trading body.

Trump has branded the WTO a "disaster" and flouted international trade norms by hitting key allies with stinging tariffs, and imposing crippling fees on Chinese goods in the name of US national security.

US news website Axios cited sources saying Trump has repeatedly told his top officials he wants to exit the world body, which Washington helped design and most often rules in favor of the United States when Washington brings cases before it.

But Treasury Secretary Steven Mnuchin said earlier it would be an "exaggeration" to say Trump is planning to quit the WTO.

"I won't use our favorite word about the fake news, but this is an exaggeration," Mnuchin told Fox Business television.

"The president has been clear with us and with others he has concerns about the WTO. He thinks there's aspects of it that aren't fair."

Although Trump complains that China and others have used the WTO system to their own advantage, "we are focused on free trade" and "breaking down barriers," Mnuchin said.

REUTERS

US Treasury Secretary Steven Mnuchin departs the North Lawn after speaking live with Fox and Friends TV from the White House in Washington on June 27.

Price drop spurs India gold demand

REUTERS, *Mumbai/Bengaluru*

GOLD demand improved this week in India as prices fell to their lowest level in nearly three months, while demand elsewhere in Asia remained tepid as investors waited for prices to fall further.

Gold futures in India were trading at around 30,419 rupees ($444.4) per 10 grams by 1010 GMT on Friday, after falling to 30,365 rupees earlier in the day, the lowest level since April 5.

"There is modest rise in demand from jewellers, but still gold is trading at a discount," said Harshad Ajmera, the proprietor of JJ Gold House, a wholesaler in the eastern Indian city of Kolkata.

Dealers in India were offering a discount of up to $2 an ounce over official domestic prices this week, compared with a premium of $1 last week. The domestic price includes a 10 percent import tax.

"Improving retail demand is giving jewellers some confidence. They are placing small orders," said a Mumbai-based dealer with a private bullion importing bank, adding "falling rupee is still confusing some."

Indian rupee hit a record low on Thursday, limiting the drop in local gold prices.

Gold imports into India, the world's second biggest buyer of the metal, could drop by 18 percent in 2018 from a year ago, according to a Reuters poll.

Spot gold hit a more than six-month low this week at $1,250.98 per ounce, as demand for remained weak and as the dollar strengthened to near one-year highs.

In top consumer China, premiums were in a range of $2-$4 an ounce against the international benchmark, versus $5-$6 last week.

"The Chinese prices have been better than the international prices due to the yuan exchange rate ... Some are eager to buy low, but still waiting," GFMS analyst Samson Li said.

China's yuan hit a 7-1/2-month low of 6.6522 on Friday.

Premiums of 80 to 90 cents were charged in Singapore, little changed from the 80 cents-$1 range last week.

Demand has been quite good in Singapore because prices are at their lowest this year, said Brian Lan, managing director at dealer GoldSilver Central in Singapore.

"Right now people who are buying gold are businesses. Some investors are waiting for prices to fall lower before they enter the market."

US trade war upends China's economic balancing act

AFP, *Beijing*

CHINA'S government is facing a multi-front battle to defend its economy, fighting to reduce its debt mountain while the yuan and local stock markets tumble in the face of a US trade conflict.

With the Trump administration preparing to roll out tariffs on some $34 billion of Chinese imports next week, the Shanghai Stock Exchange is taking a nosedive -- down some eight percent in the last two weeks before recovering on Friday.

The yuan has also come under pressure, falling to its lowest rate against the dollar since November 2017.

Louis Kuijs, head of Asia economics at Oxford Economics, said a trade war could slow China's economy by 0.3 percentage points on average over 2019-2020.

"The increased uncertainty and risks will weigh on business confidence and investment, especially cross-border investment. There will be an impact on growth, in China, the US and elsewhere," he added.

The tariffs expected to take effect July 6 are just a fraction of the total Trump has vowed to levy on China if it hits back with its own punitive measures.

As stocks fell recently, the governor of the People's Bank of China (PBOC), Yi Gang, urged investors to "stay calm and rational", assuring that the central bank would mitigate any "external shocks".

On Sunday the PBOC said it would reduce the reserve requirement rate (RRR) for most banks by 50 basis points in order to release some 700 billion yuan ($105 billion) of funds for loans for small businesses.

Lu Ting, chief China economist at Nomura International, said the move would provide "fresh liquidity for the real economy" and sent "a strong signal of policy easing".

But he added a note of caution, saying that despite the RRR reduction, "we believe the Chinese economy is yet to bottom out, and the situation could get worse before getting better."

The rate cut will come into effect on July 5 -- on the eve of the day the first wave of US tariffs are due to bite -- while the PBOC has beefed up its regular cash injections into the financial system.

But China has to be wary of pulling the easing lever too readily.

President Xi Jinping's administration has been trying since last year to curb China's significant indebtedness, tightening regulation of the banking sector and cracking down on rampant "shadow financing".

That requires a delicate balance -- if credit fully runs out of steam, companies will struggle to finance themselves.

Julian Evans-Pritchard, senior China economist at Capital Economics, said the RRR cut is "intended to support banks' debt-to-equity swaps rather than mark a shift away from deleveraging and toward monetary easing."

"But in practice, the RRR cut does seem likely to result in looser monetary conditions given signs that policymakers are becoming more concerned about the downside risks to economic activity from slowing credit growth," he added.

Industrial production, retail sales and investment slowed in May, all signs of an ongoing slowdown in the world's second largest economy.

Beijing has set a growth target of "around 6.5 percent" for 2018.

To reach this goal against "strong internal and external headwinds" expected in the second half, further easing is likely in the coming months, Nomura's Lu Ting said.

The yuan, meanwhile, has been sliding.

A weaker currency might help Chinese exporters facing US tariffs, but the PBOC could step in if the depreciation goes too far.

Evans-Pritchard says Beijing is acutely aware of a similar slide in 2015-2016 that led to a painful capital flight.

China is therefore trying to carry out a deft balancing act: supporting the economy and business loans, while continuing to stem swelling debt and financial risks.

The debt mountain, corporate defaults and trade tensions prompted the National Institution for Finance and Development, an influential Chinese government-backed think-tank, to issue a stark warning.

"We think China is currently very likely to see a financial panic," it said in a note quoted by Bloomberg. "Preventing its occurrence and spread should be the top priority for our financial and macroeconomic regulators over the next few years."

REUTERS/FILE

A woman walks past the headquarters of the People's Bank of China (PBOC), the central bank, in Beijing.