Fixing our current account deficit

SHARJIL HAQUE

ILLUSTRATION: UTTAM GHOSH

IF it was for a large, resource-rich country like the United States or Germany, a current account deficit of around USD 10 billion would be nothing. But for a small developing economy like Bangladesh, a current account deficit of USD 10 billion or four percent of GDP is definitely big enough to sound the alarm.

The current account in Bangladesh, which primarily includes our trade balance and remittance inflows, enjoyed years of surplus before slipping into a deficit last year. And things only went downhill from there with imports rapidly outpacing exports and remittance inflows, eventually bringing us to the situation that we are in today.

In retrospect, we should have seen this coming. Remittances had been running out of steam and could no longer bridge the gap between imports and exports. But what explains the lacklustre growth in exports?

The argument that subdued global demand slowed down exports no longer holds water. World economic activity is enjoying its broadest upsurge since 2010 with big advanced economies like the US experiencing record-low unemployment rates.

For starters, very little progress had been made in boosting exports through lower trade protection, product diversification or reaching bilateral trade agreements. Also, steady appreciation of the real effective exchange rate, from 2012 to 2017, slowly chipped away at our export competitiveness.

Meanwhile, the economy's appetite for imports skyrocketed. Not that it should be too surprising. After all, election years typically mean governments scrambling to spend every last penny in their coffers on some grandiose project to please the public. Whether those projects will be efficiently completed at reasonable costs is a different matter.

There were other factors at play here as well. International commodity prices began to pick up again. And there is growing consensus among economists that capital is being siphoned out of the country by over-invoicing imports. Why else would private credit shoot up to 18 percent after hovering around 13-14 percent for much of the last five years? After all, growth in nominal GDP has not picked up — so where is the excess credit-fuelled import going?

The ramifications of running a deficit this big are deep and persistent. The nominal exchange rate started weakening, prompting the central bank to sell part of its foreign exchange reserves to stabilise the currency. Most likely the central bank did not want imports to become more expensive, which would drive up inflation and hurt public confidence.

But there was one problem. By selling dollars in the interbank market, the central bank soaked up domestic currency (Taka) from the system. At a time when banks had been lending recklessly and dishing out heaps of private sector credit, removing money from the financial system only aggravated a growing liquidity crisis.

Any astute observer of monetary policy can detect that the central bank got stuck between a rock and a hard place. It tried to prevent depreciation by selling dollars and ended up fuelling the liquidity crunch. At the same time, it lowered policy rates and Cash Reserve Ratio to ease liquidity problems. That of course comes along with the risk of higher inflation. And all the while it has to worry about the growing deficit in the current account.

Even if the present deficit can be covered by future income generated by productive imports (assuming they really are productive!), running too large a deficit for too long can eventually become unsustainable. For now, the deficit is financed by a hefty surplus in the country's financial account which brings in foreign loans and foreign direct investment. But if this overseas financing decreases or is withdrawn altogether, the economy will experience a painful disruption in private consumption, investment and government spending. Make no mistake: history is replete with such examples. Thailand and Mexico in the 1990s should be good pointers.

From all indications, we might well see a sizeable deficit this fiscal year as well. Sadly though, authorities only have tough choices left in front of them. It could taper the economy's voracious appetite for imports by raising taxes or lowering public spending. Will the government make such a move?

Highly unlikely, especially right before elections. It could lower trade protection and create a more export-friendly environment. For several years now, leading economists have called for lower tariffs, but time and time again authorities have turned their back on such demands. Resistance from business leaders to opening up our markets to foreign competition has proved to be just too high. That this will seriously diminish Bangladesh's coveted goal of export-diversification appears to have no real impact on the matter.

Meanwhile, we are all hoping to see the government coming down hard on money launderers and banks with lax monitoring and risk management systems, which might at least reduce illicit outflow of funds through imports. But progress on this front remains slow and those who want to take money out continue to do so.

The upshot of all this is that the burden of managing external imbalances will fall squarely on the central bank. And the choice ahead is going to be tough: either drying up reserves to keep the currency fixed while adding to domestic liquidity problems or slowly allowing it to depreciate to a new equilibrium. Even if the central bank is wary of further depreciation, there should be no doubt that it is the better choice.

To be sure, some segments of the business community will remind us that imports will become expensive which could drive up inflation. Indeed, trade balance will worsen in the short term. But a cheaper currency will, in time, raise exports and take our trade balance to a stronger and more sustainable level than before—the J-curve effect. Not to mention that remittance inflows will also rise, helping create a healthy stock of foreign reserves. While an antidote of tighter monetary policy (lower broad money and private sector credit growth) can keep a lid on inflation should it start picking up.

We all recognise that these are tough decisions to take, that too just before elections. Leaders of the business sector will use all their influence—and influence they have in plenty—to force authorities to keep the exchange rate stable and monetary conditions easy. Let's just hope authorities can make the right call before things get really out of hand.

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PROJECT SYNDICATE

Sustaining Europe's security trio

VOLKER PERTHES

DESPITE the tensions generated by Brexit, the leaders of France, Germany, and the United Kingdom have stood together in disputes between the European Union and the United States. If their unity can be sustained, Europe's "big three" (E3) will serve the EU very well in a tumultuous future.

French President Emmanuel Macron, German Chancellor Angela Merkel, and UK Prime Minister Theresa May seem to have read from the same script regarding US President Donald Trump's withdrawal from the Iran nuclear deal and his rejection of the final communiqué of the G7 summit in June. They all disapprove of Trump's decisions to move the US embassy in Israel to Jerusalem and to withdraw the US from the United Nations Human Rights Council. And they have all criticised his escalating trade war with China.

This unity is not merely rhetorical. The UK has lately supported EU integration projects concerning foreign and security policy—much more so than before the Brexit referendum. This includes the decision to establish new headquarters for military training missions—which many view as the nucleus for a potential European military—in Africa. Britain had long resisted this initiative.

The catalyst for the UK's change of course, it seems, is Trump. There is significant evidence suggesting that Trump views the EU and some of its member-states as adversaries, rather than allies. While the US will remain the most important ally of the EU and NATO's European members, it is no longer the most reliable one. This shift has dashed hopes in the UK that post-Brexit Britain would be able to capitalise on its "special relationship" with the US, and it has highlighted for the EU the urgency of increasing its own strategic autonomy.

While the North Atlantic alliance will remain critical to European security, the EU now seeks to build the capacity to define its own strategic priorities and, if needed, act upon them, whether alone or with partners. Achieving this objective, defined in the EU's 2016 "Global Strategy," will be much easier with the UK on board.

The fact is that the EU and the UK have more international clout together than separately. The UK has significant diplomatic experience, international influence, and military and economic resources that can be brought to bear on joint ventures, just as the EU's backing can provide a major boost to UK policies on the world stage. This applies to démarches regarding major actors like China or Russia, sanctions regimes, international agreements, and strategic programmes like Galileo, the European satellite navigation system.

How exactly a post-Brexit UK can be institutionally associated with common EU decisions on foreign policy, security, and defence will have to be determined in the exit agreement. But it is possible to create a format that gives the UK a voice, not a veto. In the meantime, no decisions should be taken that would prevent or undermine the UK's post-Brexit coordination with EU foreign-policy positions, actions, and instruments. Moreover, steps can and should be taken today to strengthen ties between the EU and the UK.

Theresa May with Angela Merkel and Emmanuel Macron. PHOTO: AFP

Here, collaboration among the E3, in particular, is crucial. The E3 has already proved its potential. It initiated negotiations with Iran over its nuclear programme as early as 2003, and became the nucleus of the E3-plus-3 (China, Russia, and the US), which—along with the European Union—concluded the Joint Comprehensive Plan of Action (JCPOA) with Iran in 2015.

In the wake of Trump's decision to withdraw the US from the JCPOA, the E3—together with the EU's High Representative for Foreign Affairs and Security Policy—will prove integral to saving it, and to developing more wide-ranging solutions for dealing with Iran. But the E3 has an important role to play in other areas, too, including the conflicts in Syria and Yemen, the ongoing Israel-Palestine dispute, instability in North Africa, and maritime security in the Mediterranean, the Indian Ocean, and the South China Sea.

Depending on the issue, other relevant EU member-states—such as Italy, Poland, or Spain—will have to join the E3 in developing policies or negotiating agreements. E3 initiatives should always be coordinated with the EU's high representative, in order to take full advantage of the bloc's legitimacy and resources.

More frequent and visible strategic coordination among the E3 would support the ability of the EU and the UK to reap the benefits of mutual cooperation. It may also serve as a foundation for a pragmatic Brexit agreement that maintains close cooperation between the UK and the EU on foreign and security policy.

Whether the EU likes it or not, a credible joint initiative by France, Germany, and the UK would have a greater impact on the likes of Iran, Russia, China, or even the US than a common EU position emanating from a debate in the EU's Political and Security Committee. Fostering deeper E3 collaboration, of the kind that has been seen recently, must remain at the top of the EU's foreign-policy agenda before and after Brexit.

The fact that France, Germany, and the UK will all be members of the UN Security Council for the 2019-2020 period—France and the UK as permanent members, and Germany as an elected member—will add heft to cooperative action among them. Moreover, close collaboration within the Security Council could help to structure EU-UK foreign-policy coordination in the immediate post-Brexit transition period.

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(Exclusive to *The Daily Star*)

QUOTABLE *Quote*

CARL JUNG

(July 26, 1875–June 6, 1961)

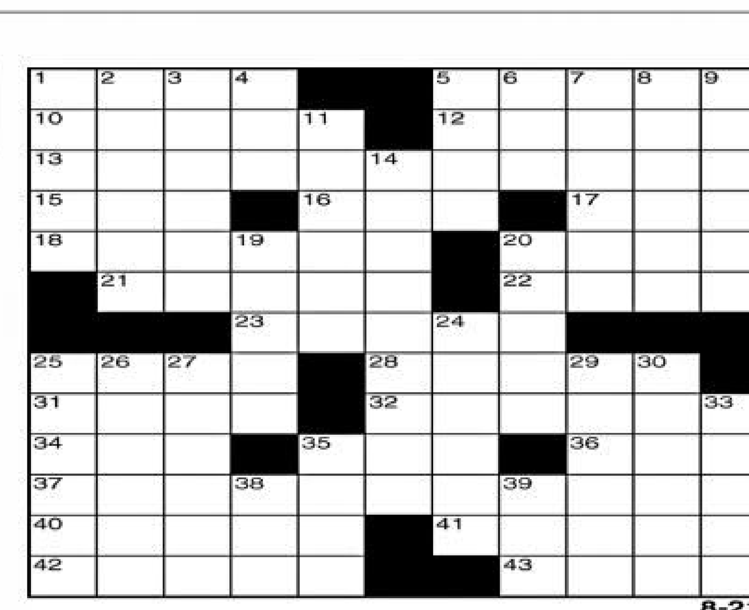
SWISS PSYCHIATRIST AND PSYCHOANALYST WHO FOUNDED ANALYTICAL PSYCHOLOGY

Who looks outside, dreams; who looks inside, awakes.

CROSSWORD BY THOMAS JOSEPH

ACROSS
1 Boars' mates
5 Opera's Callas
10 Zodiac ram
12 Some signs
13 Court filings
15 Nest item
16 Long, long time
17 Director Spike
18 Shaped
20 Midterm or final
21 Brash
22 Liberal study
23 Fable fellow
25 Bloke
28 Like fresh celery
31 Fabled race loser
32 Ill will
34 Broadcast
35 Ump's cry
36 Color
37 Sports reporters, in slang
40 Car of the '50s
41 Mail, as payment
42 State game
43 Bears' lairs

DOWN
1 Capital of 2-Down
2 North-western state
3 Move like gelatin
4 Cruise setting
5 Eve's opposite
6 French friend
7 Square dancer, at times
8 Un-pleasantly overrun
9 Desirable qualities
11 Shirt part
14 Exfoliating stuff
19 Hang loosely
20 Short putt
24 Speech maker
25 Wedding site
26 Salon creation
27 Haul in
29 Plot
30 Arrive en masse
33 Kicks back
35 Norway's capital
38 Filming site
39 Marked a ballot



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YESTERDAY'S **ANSWER**

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BEETLE BAILEY BY MORT WALKER

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