50 Years of EU-Bangladesh Partnership

# Towards a Transformed and Revitalized Trade and Economic Partnership with the EU

Mohammad A. Razzaque and Jillur Rahman

FRIEDRICH EBERT STIFTUNG Bangladesh

RAPID

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## Acronyms

| | |
|---|---|
| BAU | business as usual |
| BIT | bilateral investment treaty |
| CBAM | Carbon Border Adjustment Mechanism |
| $CO_2$ | carbon dioxide |
| $CO_2e$ | carbon dioxide equivalent |
| DCTS | Developing Countries Trading Scheme |
| EBA | Everything But Arms |
| EPI | export potential indicator |
| ESG | environmental, social and governance |
| ETS | Emissions Trading System |
| EU | European Union |
| EVFTA | EU-Vietnam Free Trade Agreement |
| FDI | foreign direct investment |
| GHG | greenhouse gas |
| GSP | Generalised Scheme of Preferences |
| GSP+ | Generalised Scheme of Preferences Plus |
| ILO | International Labour Organization |
| ITC | International Trade Centre |
| LDC | Least Developed Country |
| NDC | Nationally Determined Contribution |
| ODA | official direct assistance |
| RMG | ready-made garment |
| RoO | rules of origin |
| WTO | World Trade Organization |

# Executive summary

## Introduction

Over the past decades, the European Union (EU) has emerged as an indispensable trade and development partner for Bangladesh. The EU is by far the country's largest export market, taking almost half of Bangladesh's exports. Taking advantage of the Everything But Arms (EBA) initiative, which provides preferential duty-free and quota-free market access for goods originating from the official category of Least Developed Countries (LDCs), Bangladesh's combined exports to the EU expanded rapidly from just US$2 billion in fiscal year 2000/01 to $23.2 billion in 2021/22. In value terms, more than 80 per cent of all Bangladesh's exports that receive any tariff preferences is obtained from European markets. Bangladesh has been the single largest beneficiary of EU Generalised System of Preferences (GSP) schemes.

Along with its contribution to trade, the EU has been one of the most important development partners as well. It provides generous budget support to the government of Bangladesh, supports numerous social and physical infrastructure projects, and is a critical source of technical assistance in a wide variety of areas. Over the past five years, the cumulative official direct assistance (ODA) from EU institutions and individual EU countries amounted to $2.3 billion, which is around 10 per cent ODA disbursements in the country.

The EU is also a major source of foreign direct investment (FDI) in Bangladesh. Between 2017 and 2021, the net FDI flow from EU countries was $3.5 billion, accounting for about a quarter of all such flows into Bangladesh. The FDI stock in Bangladesh due to the EU is more than 12 per cent of the total such stock.

### Emerging challenges affecting Bangladesh-EU trade and economic relations

Bangladesh still has huge export potential in the EU as it is estimated that currently only 60 per cent of export potential is utilized. However, the nature of trade relations with the EU, or, more precisely, Bangladesh's dependence on EU trade preference, is now set to come to terms with other major developments that will require a profound transformation of the current trade and cooperation regime.

This is because of several reasons:

- **LDC graduation:** First and foremost, Bangladesh's impending graduation from the official LDC category means the unilateral trade preferential regimes offered for LDCs by trade partners, including the EU, will change. Its graduation in 2026 will result in immediate cessation of LDC-related trade preferences in such countries as Canada, China, India, Japan. Only the EU (and the United Kingdom) are set to provide a three-year grace period, and thus EBA trade preferences will come to an end in 2029. After graduation, a country can apply for some duty-free market access under the EU's Generalised Scheme of Preferences Plus (GSP+) programme[1]. However, the new GSP+ regime for 2024-34, as proposed by the EU and currently under consideration by the EU Parliament, would discontinue any benefits for Bangladesh's clothing items due to safeguard measures mentioned in its Article 29. Accessing GSP+ benefits for other products will also depend on complying with 32 specified international conventions (up from 27 under the current GSP+). As of June 2022, Bangladesh has ratified 20 of these conventions and acceded to the remaining 12. Qualifying for GSP+ will be contingent upon the ratification of the remaining conventions and effective implementations of all these conventions. Therefore, within the next few years, Bangladesh could see its market access terms in the EU changing quite remarkably.

[1] The EU's umbrella Generalised Scheme of Preferences consists of three arrangements that each remove some import duties from products coming into the EU market from vulnerable developing countries. The GSP+ and the EBA are two of the arrangements. The third is the Standard GSP, which removes all or some duties on two-thirds of tariff lines from qualifying low and lower-middle income countries.

- **Other countries' trade agreements with the EU:** While Bangladesh stands to lose trade preferences, free trade agreements (FTAs) could allow its competitors to gain competitive advantages in the EU. For instance, Vietnam, already a major apparel exporter, has secured with the EU an FTA, which came into effect in August 2020. To put things in perspective, Vietnam will see tariffs on its clothing exports to the EU gradually decline from an average of 9 per cent to zero around the same time as Bangladesh's duty-free access will be coming to an end and being replaced with an average tariff of around 12 per cent, notwithstanding the GSP+ scenario. Even countries such as Pakistan and Sri Lanka have access to GSP+ while Indonesia, which is another major apparel-supplying country, is currently negotiating an FTA with the EU.

- **The EU Green Deal and its Carbon Border Adjustment Mechanism :** The recently proposed EU Green Deal aims to make use of a Carbon Border Adjustment Mechanism (CBAM) to internalize the cost of carbon dioxide ($CO_2$) emissions in both domestically produced and imported goods. Under the CBAM, the EU wants to price the embedded carbon content in imports at an equivalent rate to the price of $CO_2$ faced by domestic firms under the EU Emissions Trading System (ETS). At the time of writing, the European Parliament and European Council have reached a provisional agreement on the terms of the CBAM. According to the deal, the CBAM will initially cover iron and steel, cement, aluminium, fertilisers and electricity, as proposed by the Commission, and extended to hydrogen, indirect emissions under certain conditions, certain precursors as well as some downstream products such as screws and bolts and similar articles of iron or steel. The Commission shall assess the methodology to capture indirect emissions, and the possibility to include more downstream products. The CBAM will enter into force in its transitional phase from 1 October 2023 where the obligations of the importer shall be limited to reporting the embedded emission on imported goods. Additional sectors are likely to be brought under coverage later. This implies that whether goods are produced in an environmentally friendly manner could soon be a major factor in export competitiveness.

- **Environmental, social and governance (ESG) compliance:** The emerging trends in global trade and investment regimes, led by the EU, seem to suggest that the future success of exports will critically hinge upon ESG compliance. While the readymade garment (RMG) sector is already under scrutiny to some extent, such standards for other sectors are also equally important and could determine future market access into the EU. The supply chain laws in the EU and individual member states may affect businesses in the developing countries that supply to the EU, including Bangladesh. Companies will have to monitor and undertake the required due diligence exercise to be able to export to the EU.

**Way forward**

The above factors call for immediate policy attention to assess the major trends and emerging issues affecting the future of trade prospects with the EU. While LDC graduation has received prominence in policy discourse, Bangladesh seems to remain focused on the existing unilateral LDC-style trade preferences.

The need for securing a trade deal (i.e. FTA) with the EU is also being highlighted by many Bangladeshi stakeholder representatives. It is often argued that other trade partners will consider Bangladesh an important partner to strike an FTA given its sustained economic growth performance, making it one of the largest 30 major economies. However, Bangladesh lacks a credible track record for undertaking and sustaining major policy reforms in such areas as trade, industrial policy, and investment, intellectual property and environmental protection, which are now considered essential for a trade agreement with any major economy. It is also not adequately appreciated that clinching a good trade deal takes a long preparatory phase and the actual negotiation itself often takes 7-10 years.

- Moving forward, Bangladesh needs to develop a long-term strategy and action plan for strengthened Bangladesh-EU cooperation.
- Bangladesh must effectively engage with the EU for securing favourable market access terms in the post-LDC graduation period.
- Securing a full-fledged free trade and investment agreement with the EU for maintaining the current market access for exports and attracting investment should also constitute a possible option.
- But it seems that either a trade deal or future preferences in the EU would require Bangladesh taking actions to ensure conformity with international conventions and standards, and to make improvements in various other related areas such as environment, investment, and intellectual property.
- Since the CBAM is going to be a feature of trading with the EU, Bangladesh should prepare and consider its options for protecting export competitiveness, including establishing a domestic carbon market, and formulating and implementing carbon reduction policies.
- Sustainable production practices of the exporting firms and the adoption of ESG-related compliances will be important determinants for export success in the future.
- Bangladesh should attract more investment and try to seek additional EU development assistance to develop domestic capacity. It should consider a bilateral investment treaty (BIT) for attracting more EU investment, and engage with the EU on this. Such an agreement should facilitate the discussion about a full-fledged FTA between the EU and Bangladesh.
- The cost of doing business is considered excessively high in Bangladesh because of such factors as infrastructural bottlenecks, inefficient customs processes, incompetent port management and trade facilitation measures, dysfunctional inland transportation, and weak governance. Tackling the high cost of doing business and investing in connectivity and trade facilitation measures will be important to boost competitiveness.

## I. Background

The EU is an indispensable trade and development partner for Bangladesh. It is the single largest export destination of the country comprising more than half of its total merchandise exports. Bangladesh enjoys duty-free market access in the EU Single Market under  the EBA initiative. More than 80 per cent of all trade preferences for Bangladesh is due to this market alone and the corresponding preference utilization rate is more than 97 per cent. Apart from providing preferential market access, the EU is also one of the most important donors of ODA, constituting one of the biggest sources of concessional loans and grants. While disaster preparedness risk reduction, building resilience, human resource development and social protection have been the traditional key priority areas of funding, the EU has also extended generous support in a range of areas including for the Rohingya refugee response and pandemic containment efforts.

The nature of trade and economic relationship with the EU, especially Bangladesh's dependence on EU trade preference, is now, however, set to come to terms with other major developments that require a profound transformation of the current trade and cooperation regime:

- The transition towards a new trade preference regime following Bangladesh's graduation from LDC status and the resultant potential loss of market-access conditions and concessional development assistance
- Loss of export competitiveness arising from other countries' trade agreements with the EU and associated trade diversion
- The implementation of the EU's Green Deal and its CBAM
- The ever-increasing importance of ESG factors influencing trade and investment prospects
- EU's corporate sustainability and supply chain regulations potentially impacting businesses in developing countries
- The geo-economic and geo-political factors affecting the EU's trade and investment policy landscape

The above unfolding developments call for immediate policy attention to assess the major trends and emerging issues affecting the future of trade prospects with the EU. There are currently hardly any informed policy discussions on the urgent need for a changed or transformed and revitalized relationship with the EU. It is thus important to sensitize the decision-makers and exporters, among other stakeholders, to the new realities and trends that will affect the future of trade and investment partnerships. This study, therefore, attempts to develop informed inputs that can provide a basis for informed policy discussions. It assesses the emerging issues that could shape the trade and economic partnership with the EU in the coming years. It also provides a set of policy recommendations based on the analytical assessment and inputs received from technical consultations with the key stakeholders.

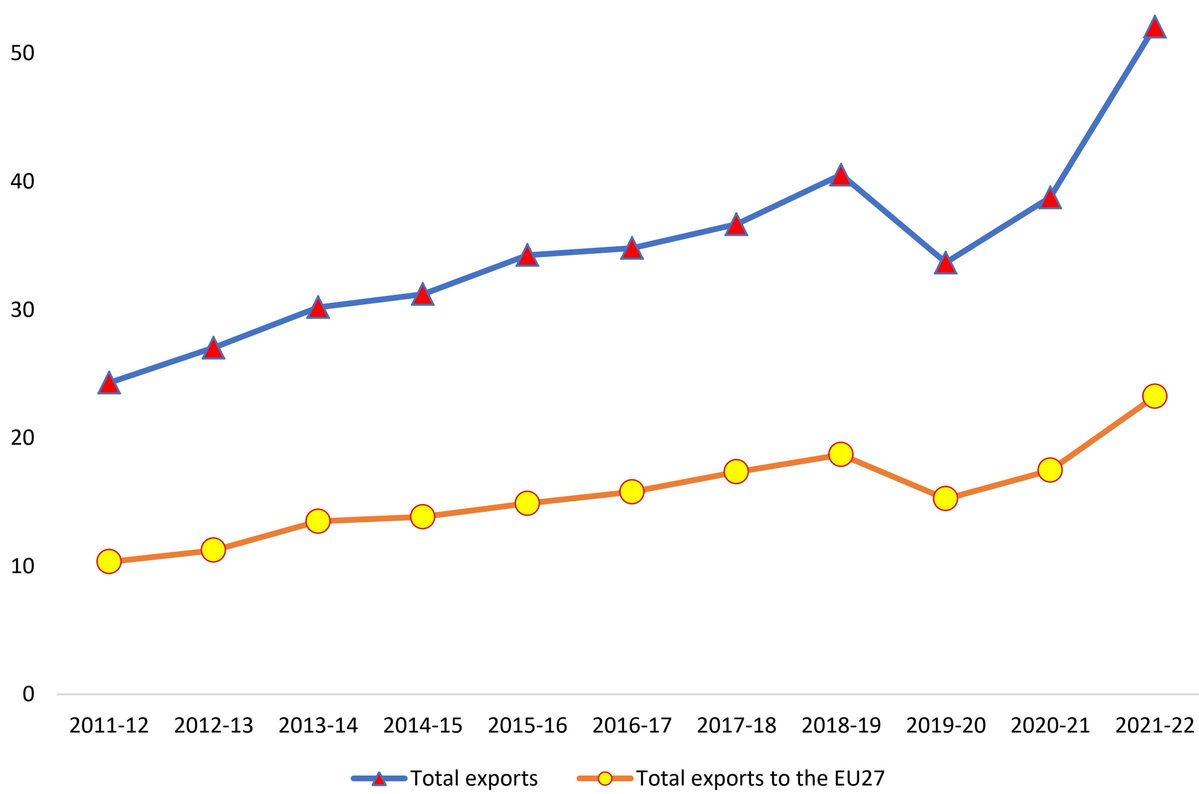
This paper is organized as follows: After this background and motivation, the next part of Section II highlights some salient features of Bangladesh's trade and economic linkages with the EU; Section III discusses the ongoing major developments that are likely to affect the current bilateral partnership regime; finally, Section IV provides some policy recommendations for a transformed and revitalized bilateral relationship going forward.

# II. Bangladesh's trade and economic cooperation with the EU

## 2.1 Bangladesh's exports to the EU

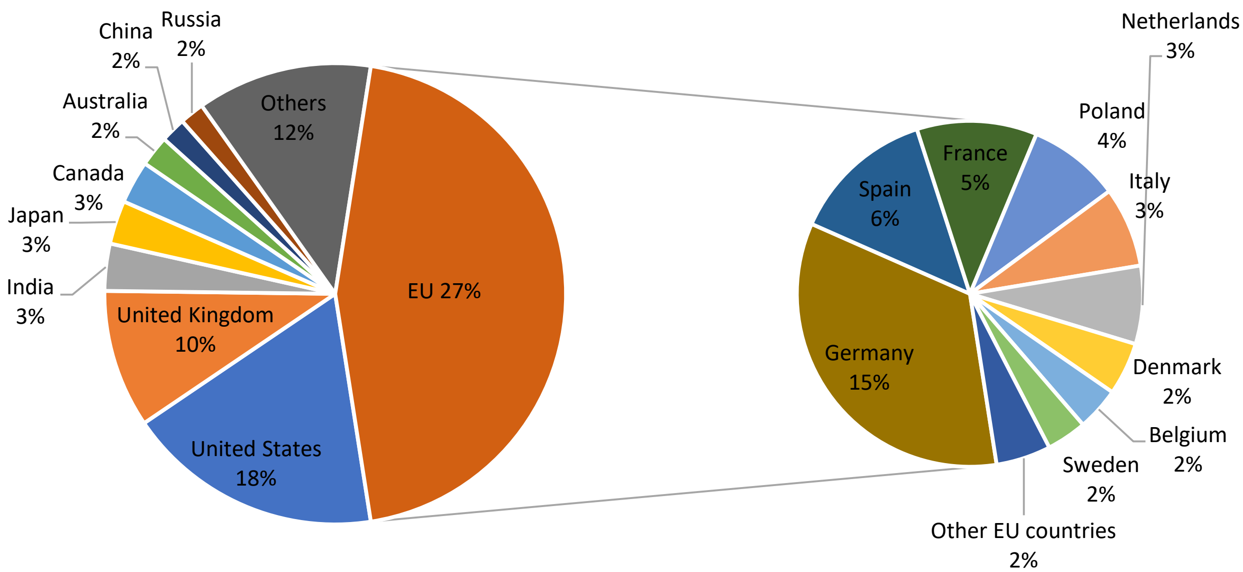
Bangladesh's total exports to the EU stood at $23.2 billion in 2020-21, increasing from just $2 billion in 2000-01 (Figure 1). Of this, $21.4 billion, or more than 90 per cent is due to apparel items (RMG) only. The EU captures around 45 per cent of the country's total exports and more than half of apparel exports (Figure 2). Over the 10-year period preceding the COVID-19 pandemic, Bangladesh's exports to the EU registered a rise of more than 10 per cent per annum.

**Figure 1: Bangladesh's exports (billion $)**




Source: Authors' presentation based on data from the Export Promotion Bureau (EPB) of Bangladesh.

**Figure 2: Bangladesh's exports to destination countries, 2020-21 (%)**

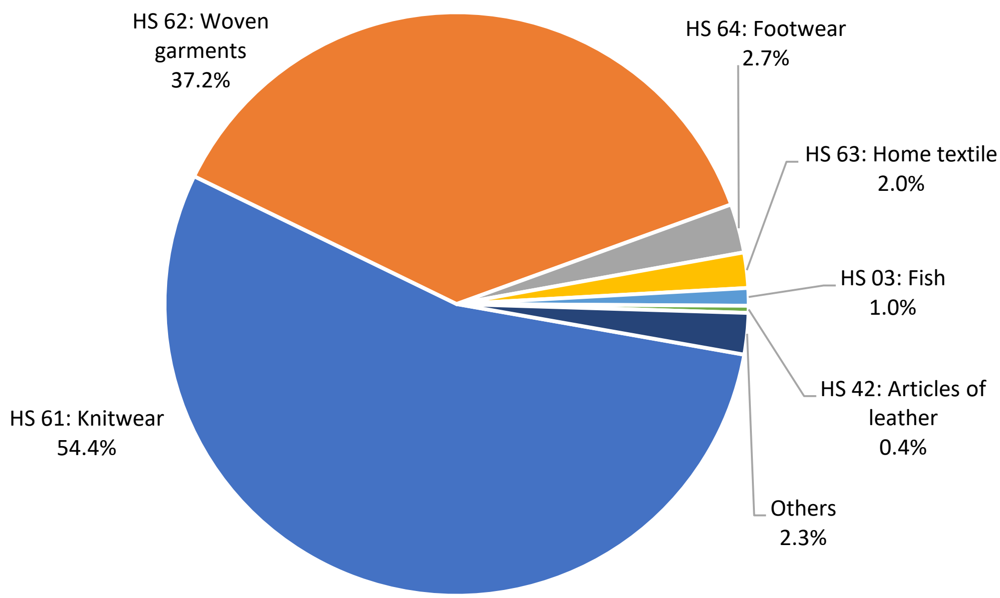



Source: Authors' presentation based on data from the Export Promotion Bureau (EPB) of Bangladesh.

Needless to mention that export success is overwhelmingly RMG-led. Apparel exports comprise more than 90 per cent of Bangladesh's total exports to the EU (Figure 3). Other significant export items include footwear, home textiles, fish, and leather articles. In 2021 bicycle exports to EU countries stood at around $100 million.

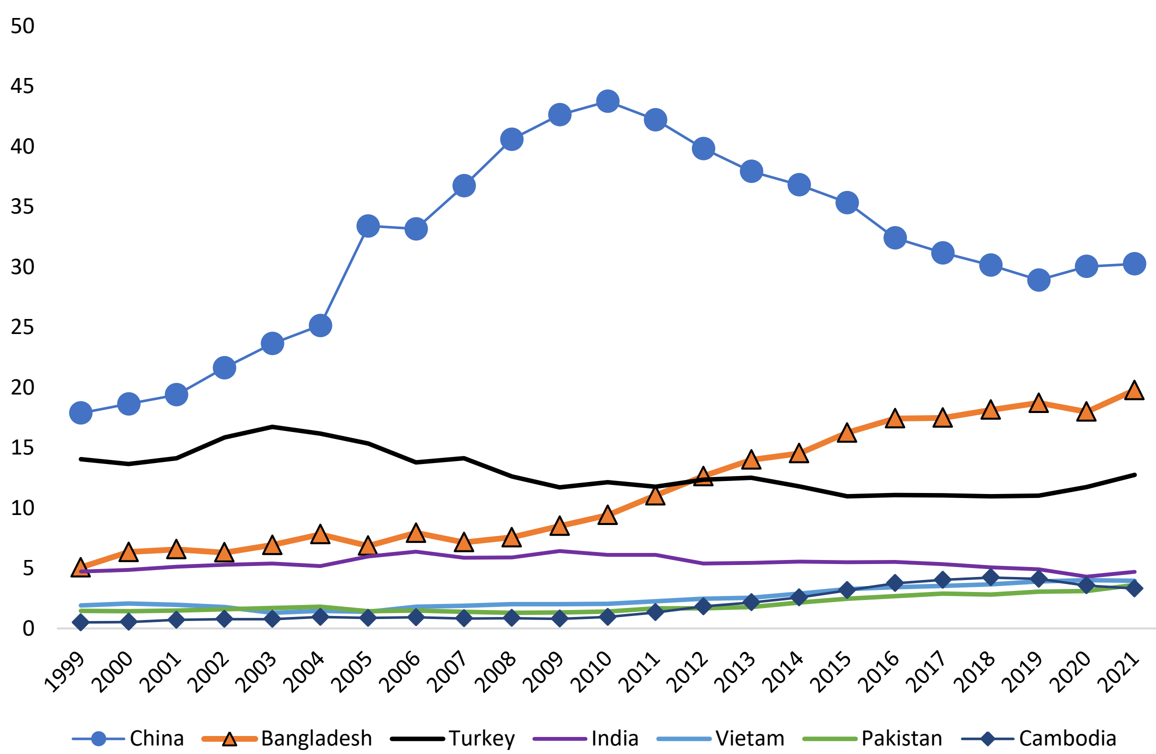
The robust export performance of Bangladesh to the EU has been shaped by its apparel products. Bangladesh is the second largest supplier of apparel items to the EU. It captures a very significant share of 20 per cent of EU apparel imports from the extra-EU countries (Figure 4). The same share is 30 per cent for China, 13 per cent for Turkey, 4.7 per cent for India, and 4 per cent for Vietnam (Figure 4). Between 2010 and 2021, China's apparel market share in the EU declined by 13 percentage points: from 43 per cent of total imports from non-EU countries in 2010 to 30 per cent in 2021. During the same time, Bangladesh's share increased by 11 percentage points (from 9 per cent to almost 20 per cent). This indicates that most of the market left by China is being captured by Bangladesh. The duty-free market access of Bangladesh under the EBA initiatives of the EU aided to expand its market in these countries. Besides, the derogation of EU rules of origin (RoO) in 2011 allowed a single transformation for LDC clothing exports under EBA, which greatly aided Bangladesh's performance to boost apparel exports (Razzaque and Rahman, 2019). It generated a reinvigorated supply from the woven garment sector, raising Bangladesh's share in EU apparel imports. Data from the Eurostat database shows that the apparel market shares in individual EU countries vary widely (Figure 5).

**Figure 3: Bangladesh's export composition in the EU, 2019-2021 (%)**



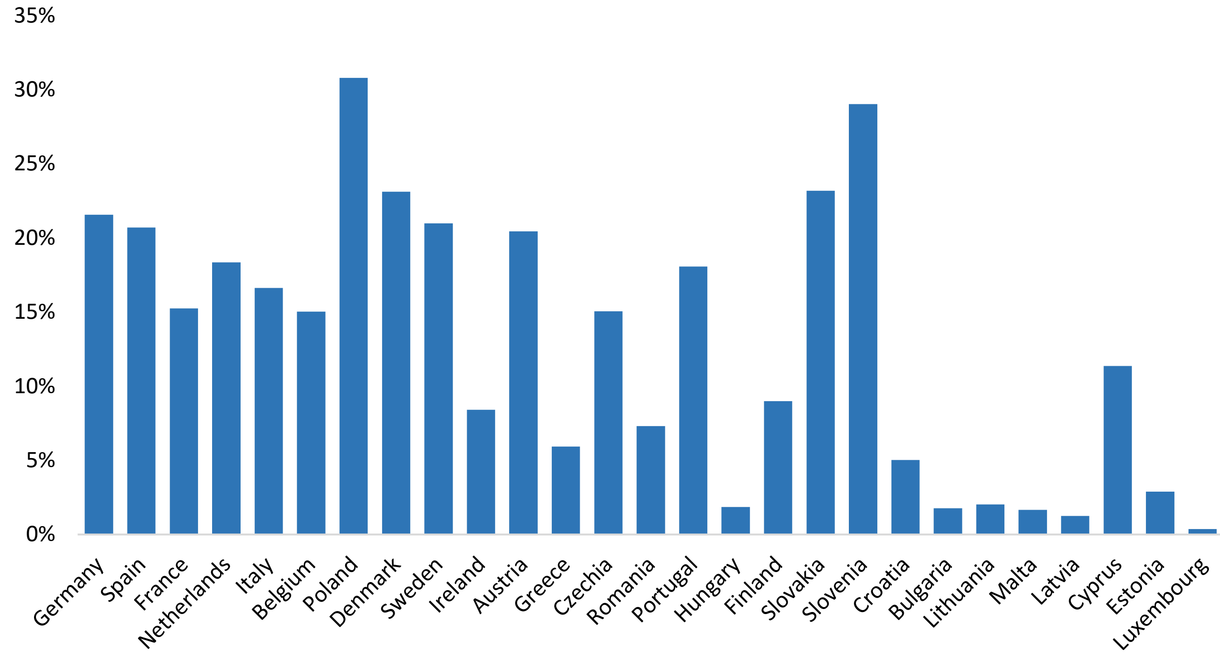

Source: Authors' presentation using data from the International Trade Centre.

**Figure 4: EU (extra-EU) apparel market shares by selected suppliers (%)**




Source: Authors' presentation using data from Eurostat.

**Figure 5: Bangladesh's apparel market share in individual countries, % (average of 2019- 21)**




Note: Countries are organized according to the apparel market size. Germany has the largest apparel market while Luxembourg has the smallest.

Source: Authors' presentation using data from Eurostat.

## 2.2 Export prospects in the EU

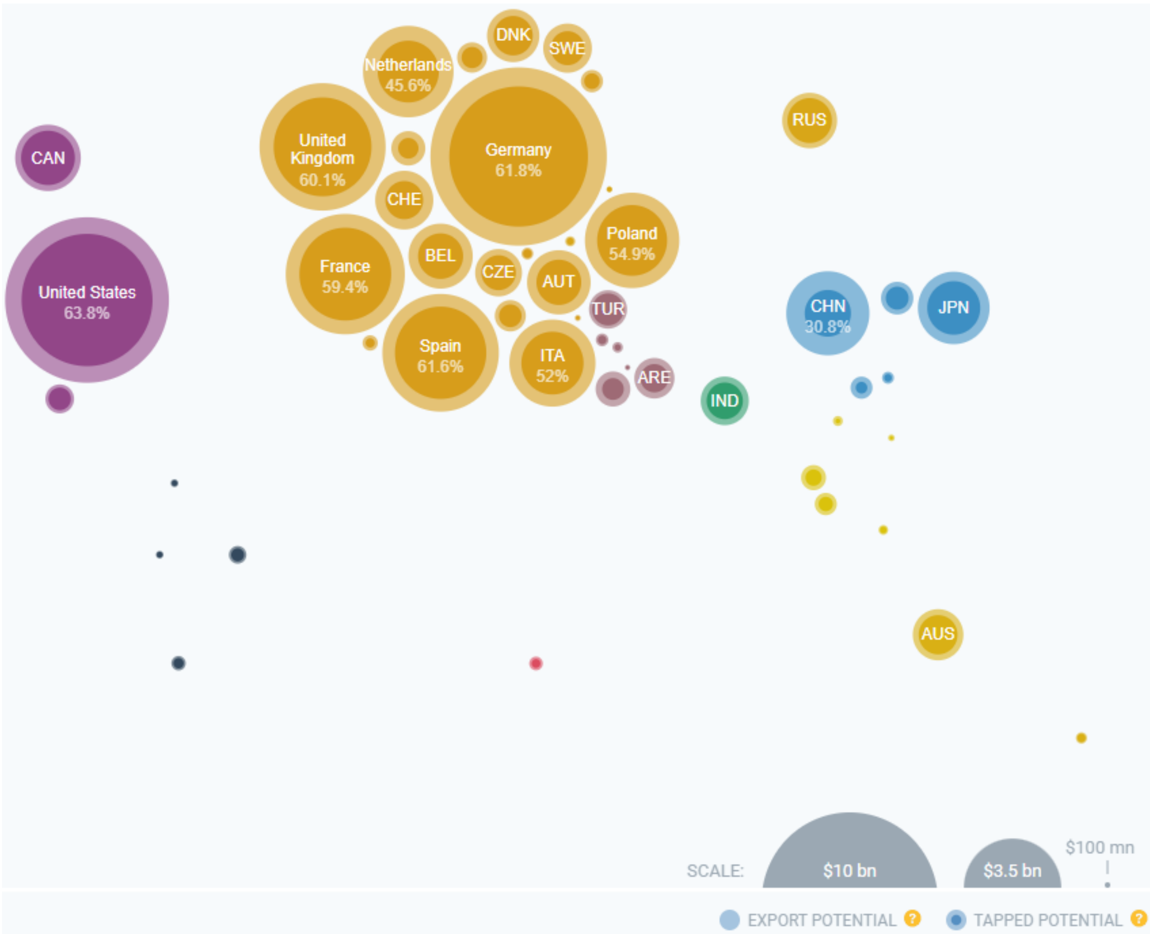
The EU offers high potential for Bangladesh's export promotion. There is evidence that Bangladesh can make more of its export potential by utilizing the advantage of duty-free market access. A method recently developed by the International Trade Centre (ITC) can be used to estimate the untapped export potential in destination markets (Decreux and Spies, 2016). The ITC export potential indicator (EPI) identifies goods for which an exporting nation has already demonstrated its ability to compete on a global scale and which have promising export prospects. Based on exporters' supply capacity, market demand, and market access conditions, the potential export value in a target market is calculated.[2] Potential export values are compared with actual export revenues, to identify untapped prospects. Bangladesh has an additional export potential of $20 billion in the EU and the UK. This will rise further.

Using the ITC tool, it is estimated that Bangladesh realizes less than 60 of its export potential in the EU market (Figure 6). Among individual EU countries, Bangladesh utilizes 62 per cent of its potential in Germany, 59.4 per

[2] The EPI has three components: exporters' supply capacity for a product, demand conditions and bilateral ease of trade. An exporter's supply capacity is estimated as a dynamic version of market share, in which expected economic growth is considered to augment the exporter's capacity, and product-specific trade balance measured by the export-to-import ratio and global margin of preference, which encompasses information on tariff preference. Demand conditions are captured through partners' projected imports, which are determined by projected growth in gross domestic product and population, margin of preference in the target market, and distance advantage, which compares suppliers' geographical distances with the target market. The ease of trade between two countries is computed based on the actual trade relative to hypothetical trade estimated by supply and demand conditions. An ease of trade between countries greater than 1 indicates that countries find it easier to trade between themselves relative to the average of world markets. The export potential is then calculated by multiplication of estimated supply capacity, demand conditions and bilateral ease of trade. Potential exports are estimated for disaggregated products at HS 6-digit level. The aggregate export potential of a country in a target market is the sum of product-level export potentials.

cent in France, 62 per cent in Spain, 54.9 per cent in Poland, 52 per cent in Italy, and 45.6 per cent in the Netherlands. Comparing actual and potential exports, it is estimated that Bangladesh has an additional $18 billion unused potential in the EU. The unutilized export potential for apparel alone is $16 billion. Overall, more than 40 per cent of potential is remaining unutilised in this market. Reasons for this potential not being utilized could be low productivity and lack of diversification.

**Figure 6: Bangladesh's export potential and untapped opportunities**

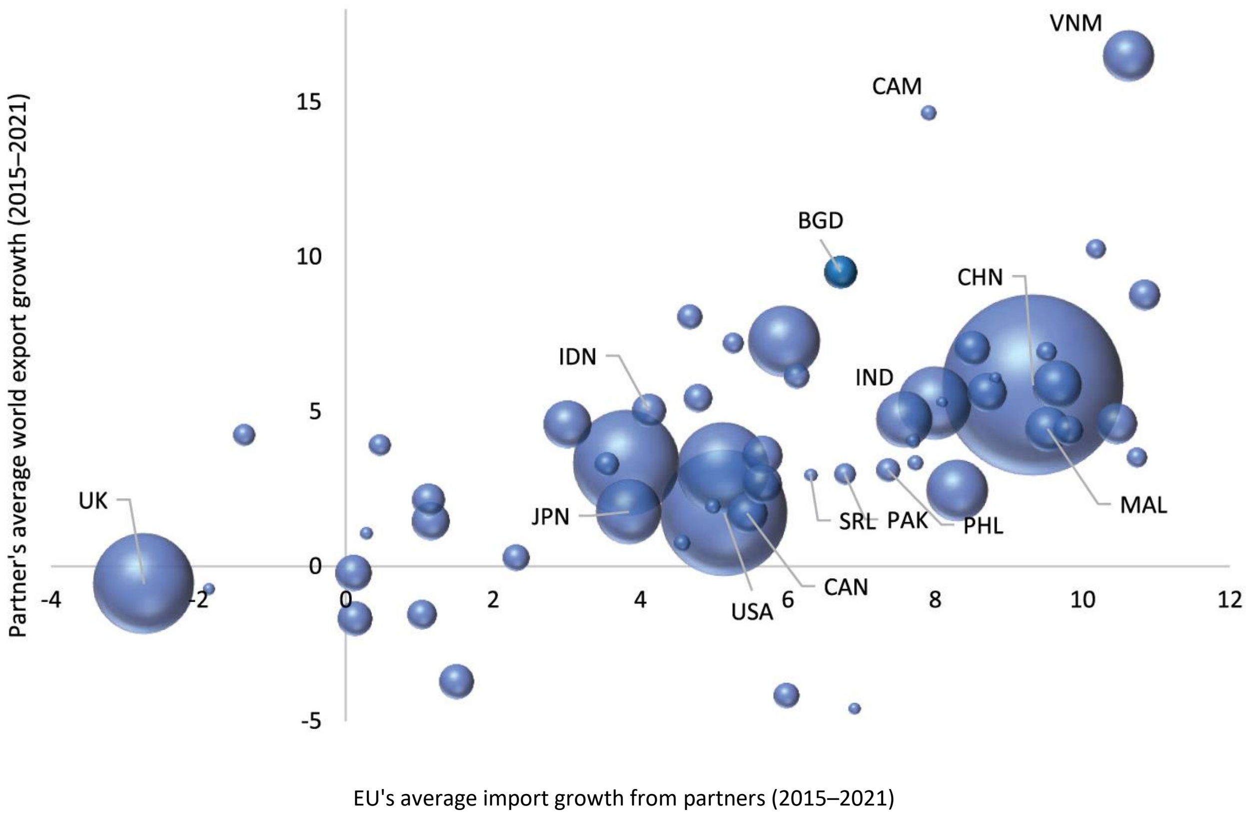



Source: ITC export potential map.

Comparison of market shares and export growth of comparator countries in a particular destination country can inform about the export prospect. The ITC has developed a methodology to assess export market prospects. It shows the recent export growth of all major suppliers and how they are performing in a particular destination country. The analysis is based on three factors viz, (i) export growth rates of competing countries in the EU market, (ii) all competing countries' export growth in the global market, and (iii) competing countries' market the share in EU market and the results are summarised in Figures 7-8.

In Figure 7, the bubble size presents market shares of major suppliers in the EU market. Bangladesh's market share in the EU for all merchandise exports is less than 1 per cent. In comparison, among the non-EU suppliers, China captures 22 per cent, the United States 9 per cent, the UK 7 per cent, India 2.2 per cent, and Vietnam 1.8 per cent. It can be inferred from the horizontal axis that, during 2015-21, the EU's import from Bangladesh increased annually by 7 per cent on average, against the EU's overall import growth of 4 per cent. During the same time, Bangladesh's overall world export growth was around 10 per cent. The relatively modest export growth of Bangladesh in the EU market compared to other suppliers and Bangladesh's overall world export growth seems to suggest a good export prospect of Bangladesh.

**Figure 7: Export prospects in the EU**

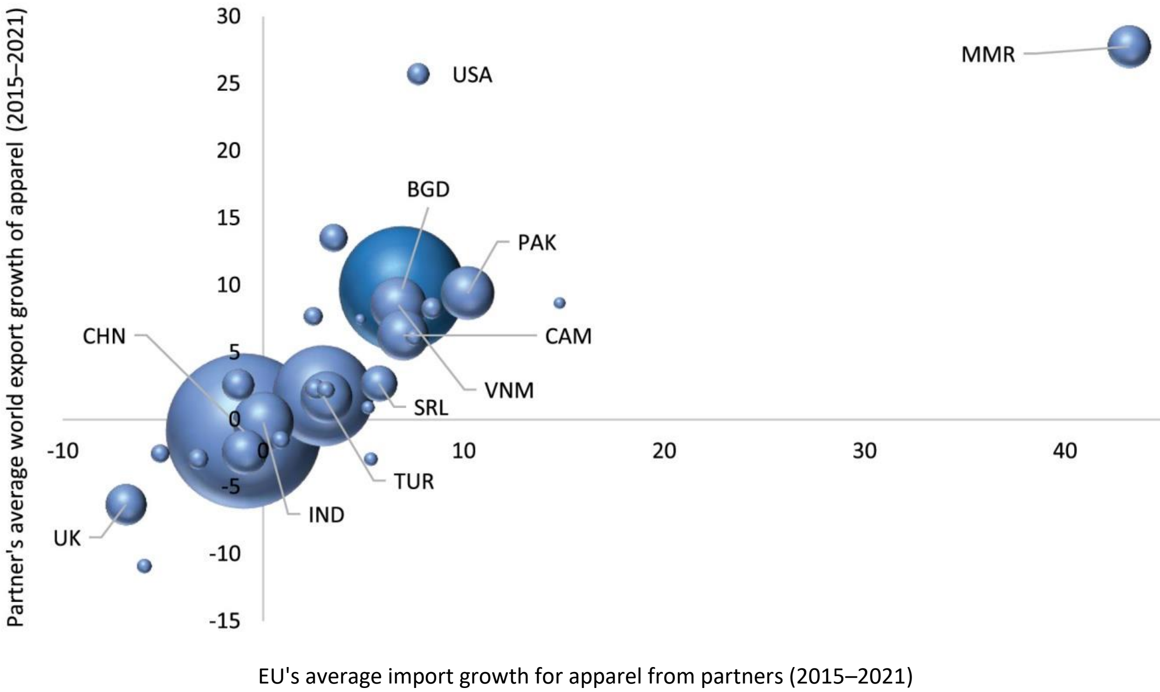



Note: The bubble sizes represent shares of various suppliers in the EU market from non-EU suppliers. The chart includes the non-EU countries only. Countries are indicated as BGD—Bangladesh, CAM—Cambodia, CAN—Canada, CHN—China, IND—India, PAK—Pakistan, PHL—the Philippines, SRL—Sri Lanka, UK—the United Kingdom, USA—the United States of America, and VNM—Vietnam.

Source: Authors' analysis using International Trade Centre data.

Figure 8 shows Bangladesh having a 20-per-cent market share in EU apparel imports from non-EU countries. During 2015-2021, the EU's overall apparel imports grew annually at less than 2 per cent. During the same time, imports from Bangladesh increased by 7 per cent annually. Bangladesh's global apparel exports at this time experienced a 9-per-cent growth. Vietnam achieved comparable growth rates in the EU and global markets. However, Chinese total apparel exports in the EU and global markets shrank by 1 per cent annually during the reference period. The comparison seems to suggest that Bangladesh has huge prospects to expand its apparel exports to the EU, especially when the duty-free market access will continue until the end of 2029.

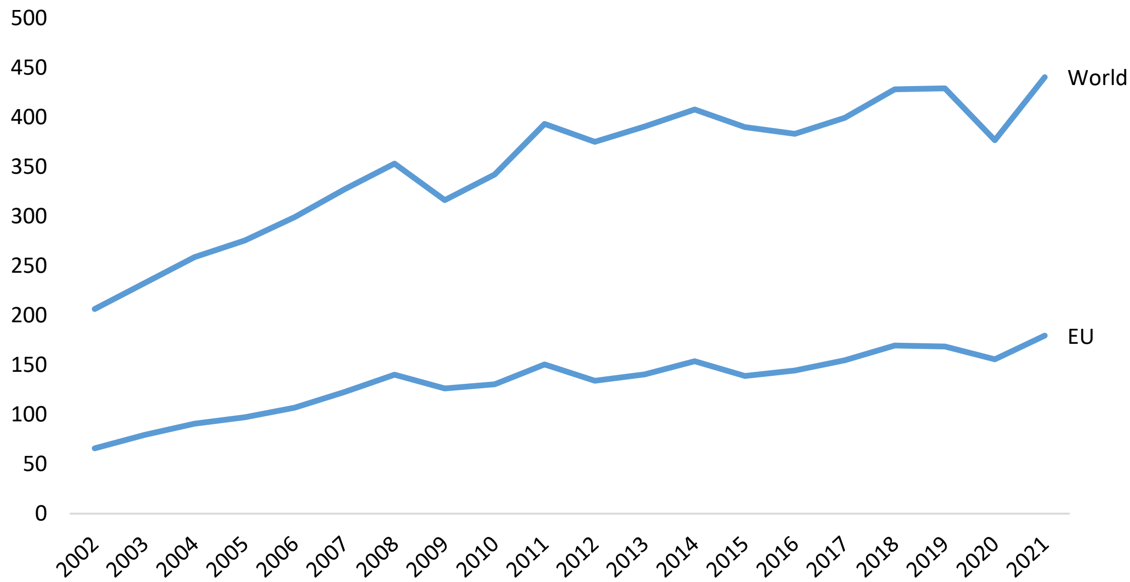
**Figure 8: Apparel export growth prospects in the EU**




Note: The bubble sizes represent shares of various suppliers in the EU market from non-EU suppliers. The chart includes the non-EU countries only. Countries are indicated as BGD—Bangladesh, CAM—Cambodia, CHN—China, IND—India, PAK—Pakistan, MMR—Myanmar, SRL—Sri Lanka, TUR—Turkey, UK—the United Kingdom, USA—the United States of America, and VNM—Vietnam.
Source: Authors' analysis using data from the Eurostat and International Trade Centre (ITC).

The $6.3-trillion EU merchandise import market, i.e., 30 per cent of global such imports, offers large export earning opportunities for Bangladesh. The apparel market size of the EU reached $180 billion in 2021 (Figure 9), accounting for more than 40 per cent of the global apparel market. Currently, half of all apparel items imported, i.e. a value of $90 billion, into EU countries is sourced from non-EU suppliers. This is almost identical to US clothing imports. The corresponding market size is just $11 billion in China, $10 billion in Canada, and just $1.1 billion in India (Table 1). Bangladesh has duty-free market preference in the EU, while other major suppliers such as China, India, Cambodia, and Vietnam do not have such preferential market access. Only recently the EU-Vietnam FTA has been operationalized, as a result of which EU tariffs on imports from Vietnam are being reduced gradually and by 2027 will be abolished. On the other hand, none of the major apparel-exporting countries has tariff-free access to the US market.

**Figure 9: Apparel market size (billion $)**




Source: Authors' presentation using ITC data.

**Table 1: Global apparel market (billion $)**

| | Apparel market size ($ billion) | Share in global apparel imports (%) |
|---|---|---|
| **World** | 440.5 | 100.0 |
| **United States** | 87.3 | 19.8 |
| **Germany** | 41.9 | 9.5 |
| **France** | 24.2 | 5.5 |
| **Japan** | 23.8 | 5.4 |
| **United Kingdom** | 20.8 | 4.7 |
| **Spain** | 18.5 | 4.2 |
| **Netherlands** | 16.4 | 3.7 |
| **Italy** | 16.2 | 3.7 |
| **Poland** | 12.5 | 2.8 |
| **China** | 10.7 | 2.4 |
| **Korea, Rep.** | 10.5 | 2.4 |
| **Canada** | 9.7 | 2.2 |
| **Belgium** | 9.0 | 2.0 |
| **Switzerland** | 8.3 | 1.9 |
| **Hong Kong** | 8.0 | 1.8 |

Source: Authors' presentation using ITC data.

The EU offers high potential for Bangladesh's export diversification in this market. The ITC Export Potential Map is a useful tool to analyse the opportunities for product diversification. The analysis using this product diversification indicator suggests that such exports from Bangladesh as footwear, fish, leather and leather goods, pharmaceutical products, bicycles, plastic and plastic goods, ceramic items, processed food, or electric machinery, have high growth potential in the EU market (Figure 10).[3]

[3] The Product Diversification Indicator estimates supply using the Product Space Methodology, which establishes links between products based on how frequently they coincide in countries' export baskets. It assumes that products that are often exported together rely on similar capabilities for their production. Supply is combined with the target market's demand and market access conditions to ensure that feasible products for the exporter also have favourable chances of export success.

**Figure 10: Potential products for export diversification in the EU**


Source: ITC Export Potential map.

## 2.3 EU's development cooperation and investment in Bangladesh

Apart from exports, the EU is a significant donors of development assistance to Bangladesh. The cumulative ODA from EU institutions and individual EU countries over the past five years amounted to $2.3 billion (Figure 11), which is around 10 per cent of all ODA disbursements during the same time. More than one-third of EU ODA in Bangladesh is disbursed by EU institutions (Figure 12). Among the individual EU countries, Germany is the largest donor to Bangladesh, followed by Sweden, the Netherlands, France, and Denmark. The EU institutions and Germany are among the top 10 donors to Bangladesh; their combined assistance was higher than that of the United Kingdom in the past five years (Figure 13). Since 2019, the EU has provided budgetary support to the government worth €247 million to promote reform activities in and strengthen the national social protection system. Also, it has been providing extended support in response to the Rohingya refugee crisis and pandemic containment efforts.

**Figure 11: EU ODA disbursement to Bangladesh (million $)**

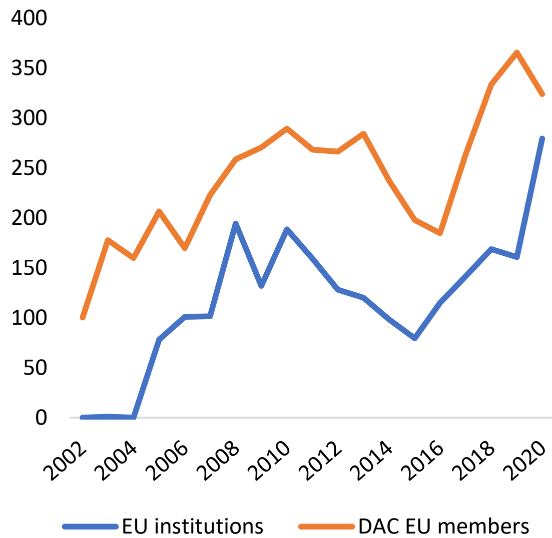
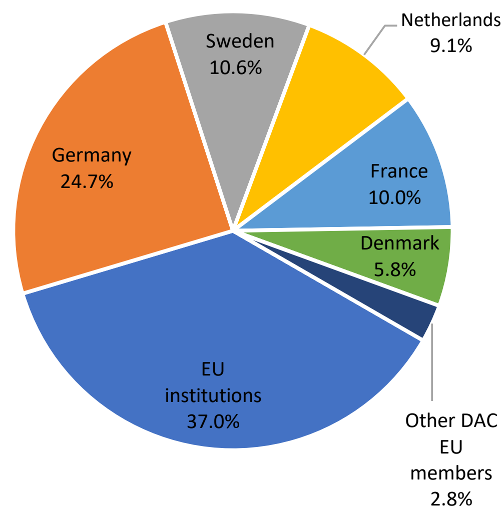
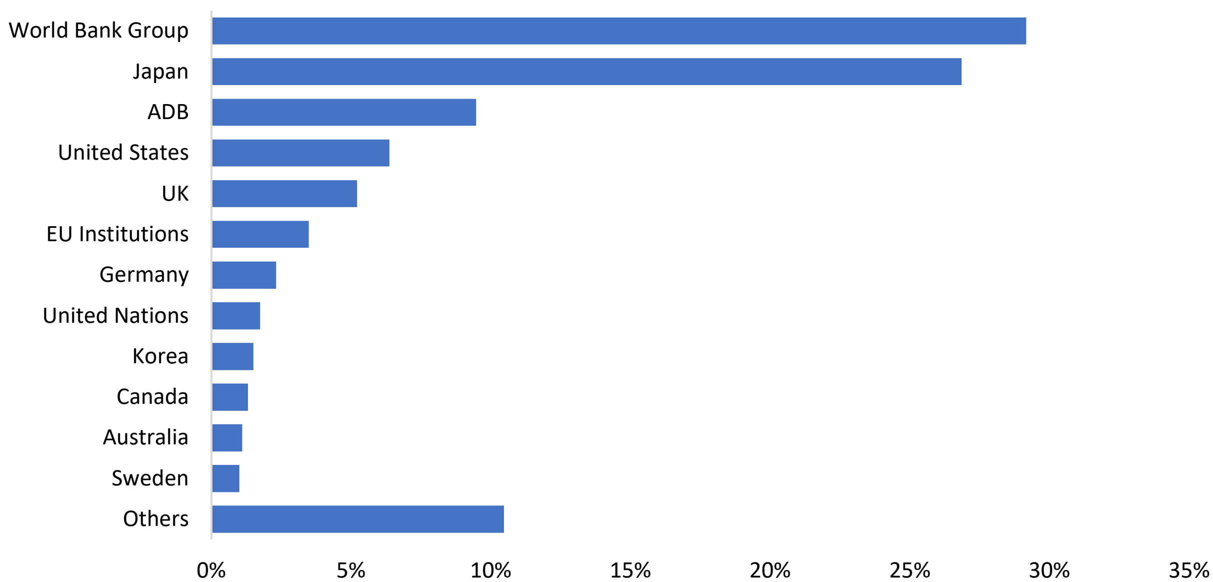



**Figure 12: Major EU ODA donors to Bangladesh, average of 2016-20 (%)**




Source: Authors' presentation based on OECDstat data.

**Figure 13: Major official donors to Bangladesh, 2016-20 (%)**




Source: Authors' presentation based on OECDstat data.

The EU is also a source of FDI in Bangladesh. Over the previous five years, the net FDI flow from EU countries was $3.5 billion (Figure 14), around a quarter of all such flows. The EU FDI stock in Bangladesh in December 2021 stood at more than 12 per cent of the total such stock. Among EU members, the Netherlands has the largest FDI stock in Bangladesh, followed by Germany, France, and Denmark (Figure 15). The Netherlands was the only EU member among the top 15 FDI partners of Bangladesh in the last five years (Figure 16).

**Figure 14: Net FDI inflows in Bangladesh (million $))**

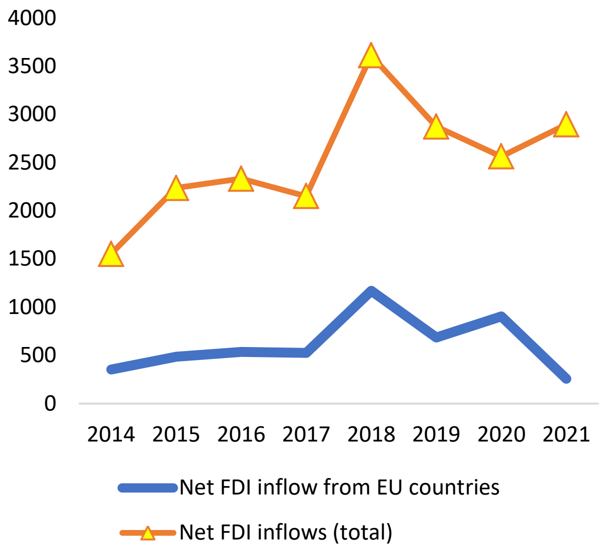



**Figure 15: FDI stock in Bangladesh from major EU countries, as of December 2021 (million $)**

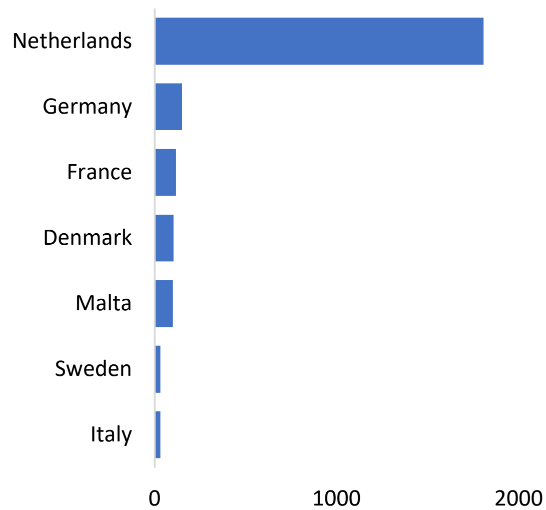
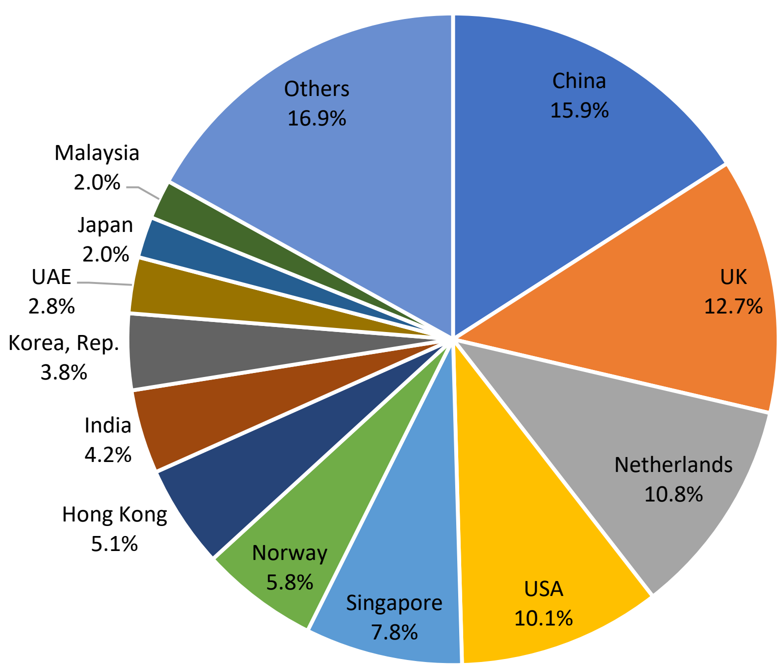



**Figure 16: Major FDI (net) partners of Bangladesh, 2017-21 (%)**




Source: Authors' presentation based on Bangladesh Bank data.

# III. Emerging challenges affecting Bangladesh-EU trade and economic relations

The EU has been a longstanding and critical trade and development partner of Bangladesh. As mentioned above, the duty-free market for exports and financial and technical assistance have had a profound impact on Bangladesh's development. The nature of trade relations with the EU, or, more precisely, Bangladesh's dependence on EU trade preference, is, however, now set to come to terms with certain developments, potentially impacting the future course of trade and cooperation. This section outlines some of these issues.

### 3.1 Bangladesh's graduation from the group of Least Developed Countries and the likely impact on trade preference and development finance

As an LDC, Bangladesh enjoys duty-free market access for almost all items in the EU. Taking advantage of it along with relaxed RoO requirements, Bangladesh's exports to the EU expanded rapidly. Bangladesh is set to graduate from the group of LDCs in 2026 while retaining all LDC-related trade preferences in the EU for another three years (until November 2029). After graduation, it will not be eligible for EBA market access. The current EU GSP scheme will expire in December 2023. The EU has announced its proposed GSP regime for 2024-34, which will be relevant for Bangladesh from December 2029. It is important to analyse the proposed scheme to assess graduation implications for Bangladesh's exports in the post-LDC period.

Graduating Bangladesh can apply for GSP+, one of the three arrangements in the overall GSP scheme. It is the second-best preferential regime after EBA, offering duty-free access for 66 per cent of EU tariff lines including apparel items. According to the proposed GSP 2024-34, graduating LDCs will qualify for GSP+ preference contingent upon fulfilling two criteria. First, the vulnerability criterion stipulates that the eligible country must have a non-diversified economy, defined as the country's seven largest sections of GSP-covered imports representing more than 75 per cent in value of its total GSP-covered imports to the EU during the past three consecutive years.[4] The sustainable development criterion, on the other hand, requires a beneficiary country to ratify and effectively implement 32 international agreements and conventions on human rights, labour rights, environmental protection and climate change, and good governance.[5]

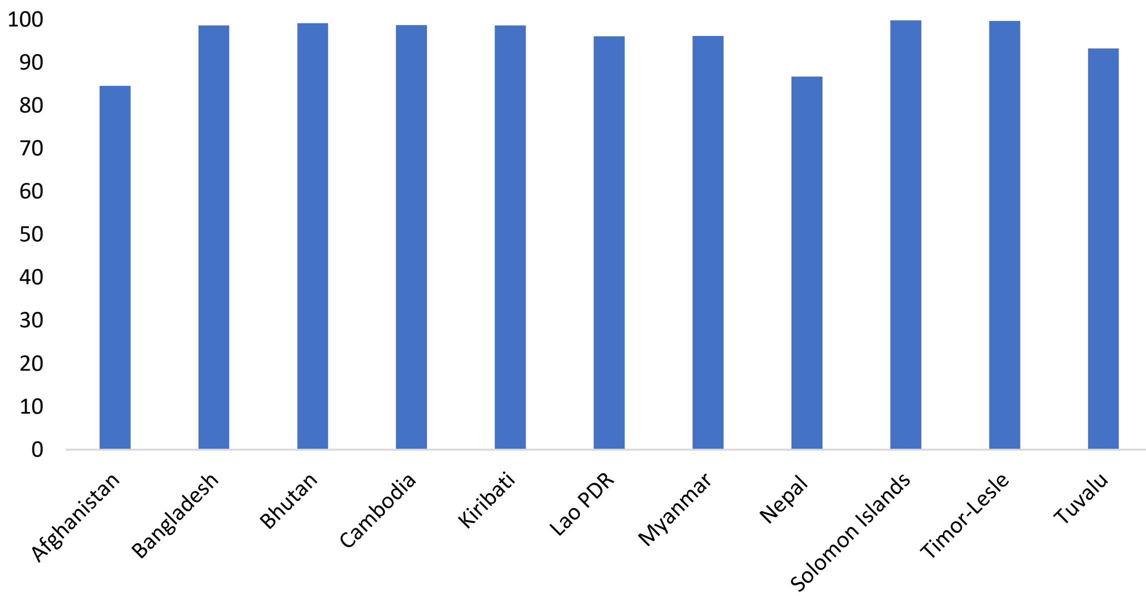
Bangladesh meets the vulnerability criterion, as the seven largest sections of GSP-covered imports represent more than 75 per cent in value of its total GSP-covered imports to the EU (Figure 17). Therefore, inclusion in GSP+ depends on ratification and effective implementation of the pre-specified 32 international conventions.[6]

[4] It is important to note that the newly proposed GSP scheme removes the import-share condition from the GSP+ vulnerability criterion to ensure a smoother transition and continued access to GSP+ status as countries graduate from their LDC status. This will certainly help Bangladesh to qualify for the GSP+ scheme, if the other criteria are met. Previously Bangladesh would not qualify the import share criteria.

[5] The new proposals also update the sustainable development criterion by expanding the list of international conventions to 32 (from the current list of 27). The new international conventions and agreements added to the GSP list include, the Paris Agreement on climate change 2015 (replacing the Kyoto Protocol); the Convention on the Rights of Persons with Disabilities (CRPD); the Optional Protocol to the Convention on the Rights of the Child on the Involvement of Children in Armed Conflict (OP-CRC-AC); ILO Convention No 81 on Labour Inspection; ILO Convention No 144 on Tripartite Consultation; and the UN Convention against Transnational Organized Crime.

[6] As of June 2022, Bangladesh has ratified 20 of these conventions and acceded to the remaining 12. Qualifying for GSP+ will therefore be contingent upon the ratification of the remaining conventions and effective implementations of all these conventions**.** Bangladesh ratifies the Paris Agreement on climate change 2015 on 21 September 2016, the Convention on the Rights of Persons with Disabilities (CRPD) on 30 Nov 2007, the Optional Protocol to the Convention on the Rights of the Child on the Involvement of Children in Armed Conflict (OP-CRC-AC) on 6 Sep 2000; ILO Convention No 81 on Labour Inspection on 22 Jun 1972; ILO Convention No 144 on Tripartite Consultation on 17 Apr 1979. It accessed to the UN Convention against Transnational Organized Crime but did not yet ratify.

**Figure 17: Share of the country's seven largest GSP-covered products to the EU (%)**




Source: Razzaque (2022)

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*Bangladesh meets the vulnerability criterion for GSP+. Thus, access to GSP+ depends on ratification and effective implementation of the pre-specified 32 international conventions.*

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Even if the graduating Bangladesh is included in GSP+ upon complying with international conventions, apparel exports will likely be subject to EU safeguard measures, resulting in exclusion from any preferential treatment.[7] According to EU provisions on "Safeguards in the Textile, Agriculture, and Fisheries Sectors" (Article 29 of the proposed EU GSP), clothing products from a GSP+ beneficiary will not receive preferential access if the share of the relevant products is above 6 per cent of total EU imports of the same products and exceeds the product graduation threshold during a calendar year.[8] The safeguard mechanism on these products will not apply to EBA recipients, nor to other GSP recipient countries with a proportion of relevant products that do not exceed 6 per cent of total EU imports of the same products (Article 29, paragraph 2 of the proposed EU GSP 2024-34).

[7] This section draws on Razzaque (2021, and 2022).

[8] The new GSP proposal exempted EBA and GSP+ beneficiaries from product graduation. However, in Article 29, under the Safeguard mechanism in the textile, agriculture and fisheries sectors, it is mentioned that "On 1 January of each year, the Commission, on its own initiative and in accordance with the advisory procedure referred to in Article 39(2), shall adopt an implementing act in order to remove the tariff preferences referred to in Articles 7 and 12 with respect to the products from GSP sections S-11a and S-11b or to products falling under Combined Nomenclature codes 22071000, 22072000, 29091910, 38140090, 38200000, 38249956, 38249957, 38249992, 38248400, 38248500, 38248600, 38248700, 38248800, 38249993, and 38249996 where imports of such products, originate in a beneficiary country and their total value: (a) for products falling under Combined Nomenclature codes 22071000, 22072000, 29091910, 38140090, 38200000, and 38249956, 38249957, 38249992, 38248400, 38248500, 38248600, 38248700, 38248800, 38249993, and 38249996 exceeds the share referred to in point 1 of Annex IV of the value of Union imports of the same products from all countries and territories listed in Annex I, columns A and B, during a calendar year; (b) for products under GSP sections S-11a and S-11b exceeds the share referred to in point 3 of Annex IV of the value of Union imports of products in GSP sections S-11a and S-11b from all countries and territories listed in Annex I, columns A and B, during a calendar year."

Bangladesh's current exports under GSP section S-11b (which are clothing items) are way above the threshold 6 per cent market share in the EU (Figure 18). Under such circumstances, the share of those products as a percentage of EU GSP-covered imports of the same products cannot be more than 37 per cent for attracting any tariff preference. However, Bangladesh's share is almost half of all GSP-covered clothing imports into the EU (Figure 19). As a result, if the proposed GSP rules are not amended, Bangladesh would be in a unique position to qualify for GSP+ but its clothing items (S-11b) will be ineligible for any preference and end up paying most-favoured-nation (MFN) duty.[9] In this case, clothing exports of Bangladesh to the EU, which comprise more than 90 per cent of exports to this market, will face around 12 per cent tariff against the current zero duty under EBA. For other items, Bangladesh may be able to access GSP+ tariff preference.

**Figure 18: Share of Asia-Pacific graduating country's exports of S-11b (HS61, HS62 and HS63) in EU imports (%)**

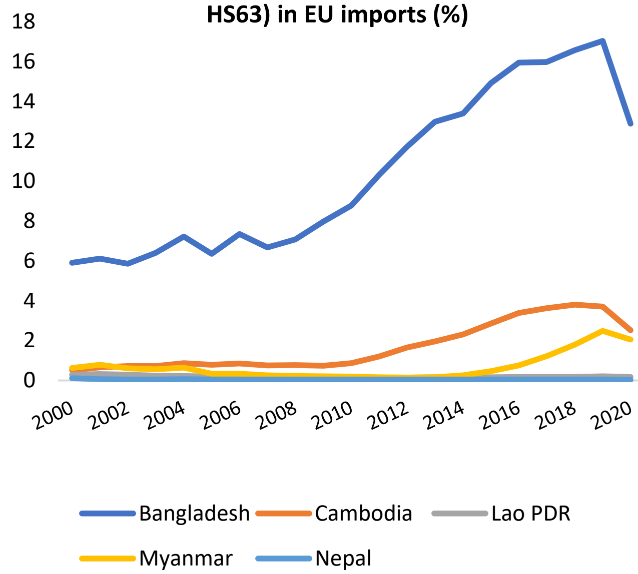
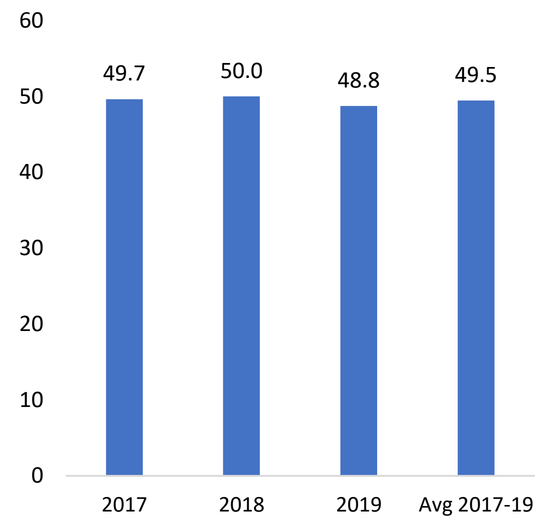



**Figure 19: Bangladesh's exports under GSP section S-11b (% of GSP covered imorts in the EU)**




Source: Razzaque (2022)

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*Accessing various provisions of the new proposals seems to suggest that Bangladesh would be in a unique situation to qualify for GSP+, yet its textile and clothing products will not be eligible for duty-free access due to EU safeguard measures.*

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Graduation would imply stricter RoO to benefit from preferential access. Under EBA, LDCs can benefit from market access with a single-stage transformation (i.e., from imported fabric to apparel making). The EU derogation of RoO requirements for textile and clothing for LDCs in 2011 from double to single-stage transformation reinvigorated the supply response from Bangladesh, especially for woven garments. Post-graduation, to qualify for trade preferences (either for GSP+ or Standard GSP) clothing items need to go

[9] The MFN principle expresses that country members of the WTO should treat all trade partners equally, with none being "more favoured" than others. It means no country should give special treatment to goods or services coming from one particular trading partner. However, there are two major exceptions to this provision for forming FTAs and grating trade preferences to developing countries. WTO members can enter into FTAs, which allow them to grant preferential treatment to each other, in the form of reduced tariffs or other trade barriers. However, these agreements must meet certain criteria and be reported to the WTO. The other is the so-called "Enabling Clause," which allows countries to provide preferential treatment to developing countries in the form of reduced tariffs or other trade barriers, without violating the WTO's non-discrimination principle.

through double transformation; in other words, preference-seeking countries will have to prove that they can produce fabrics and that domestically produced fabrics are used in making garments. Bangladesh has strong backward linkages for knitted garments. However, a relatively weak backward linkage will be a major issue for obtaining preferential treatment for woven garments based on double-stage transformation. However, if Bangladesh's apparel items attract safeguard measures and do not benefit from tariff preferences, there is no need to comply with RoO conditions.

The minimum value addition requirements for all other exports, apart from apparel, will increase from the current 30 per cent for LDCs to 50 per cent. With a weak supply-side capacity, a higher domestic value-added content for non-apparel exports would pose a major challenge for Bangladesh. The Neighbourhood Development and International Cooperation Instrument – Global Europe, established by EU Regulation 2021/947 of the European Parliament and Council (9 June 2021), refers to reinforcing the goal of allocating between 0.15 and 0.20 per cent of the EU's gross national income (GNI) to ODA to LDCs (and achieving 0.20 per cent by 2030). Under the current framework, it is not clear whether graduation would lead to changes in EU aid allocation. The fulfilment of 0.2 per cent of GNI as foreign assistance to LDCs would increase ODA resources for LDCs. This might be seen as a missed opportunity for graduating Bangladesh in the future.

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*Access to official development assistance from the EU is not expected to be hampered by graduation from LDC categorization, as EU institutions generally do not account for LDC status as an eligibility criterion for aid allocation. However, the goal of allocating 0.15 to 0.2 per cent of the EU's GNI to ODA to LDCs would increase the resource for LDCs. This can be a missed opportunity for Bangladesh.*

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Apart from the aid allocation from the EU institutions, individual countries of the Union provide concessional loans or grants to Bangladesh. Germany, Sweden, France, and Denmark are the largest bilateral donors of Bangladesh from the EU. Most of the EU countries, except for Germany, do not consider the LDC category as a pre-condition for development assistance. Germany evaluates the LDC category in ways that imply graduation might have some influence on which nations are prioritized, as well as the nature and terms of aid provided. Therefore, LDC graduation of Bangladesh would have some implications on the types of assistance from Germany.

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*Bilateral EU donors, with the exception of Germany, do not consider LDC status in their aid allocation requirements. Post-graduation the types of assistance from Germany may change from grants to concessional loans.*

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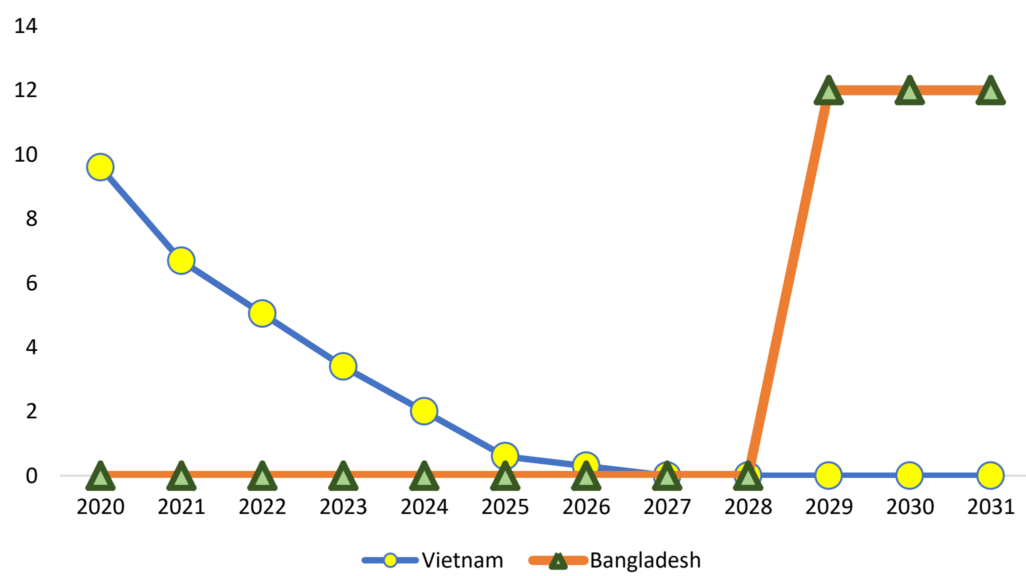
### 3.2 Loss of competitiveness arising from other countries' trade agreements with the EU

FTAs involving major trading partners (such as the EU) cause preference erosion for the countries such as Bangladesh, which receive unilateral non-reciprocal market access. While graduating LDCs may lose their most liberal unilateral trade preferences, other nations may gain more competitiveness because of FTAs, making the latter more attractive supply sources.

Currently, several trade negotiations are under way, and a few have already materialized. Among others, the EU-Vietnam Free Trade Agreement (EVFTA) and the Investment Protection Agreement, and the EU-Singapore Trade and Investment Agreement have been signed and made effective. The EVFTA entered into force in August 2020. Its tariff reduction provisions show that the EU will eliminate tariffs on 99 per cent of product lines for Vietnamese exports within a transition period. As such, all tariffs on Vietnamese apparel exports will be eliminated in seven years from the FTA's entry into force. To put things in perspective, Vietnam will see tariffs on its clothing exports to the EU gradually decline from an average 9.6 per cent to zero around the same time as Bangladesh's duty-free access is set to come to an end and be replaced with an average tariff of around 12 per cent (Figure 20), if it encounters the safeguard measures under the new EU GSP proposal 2023-34. This could cause considerable trade diversion for Bangladesh, as it would be less competitive relative to Vietnam.[10]

*Vietnam will see its tariff on clothing exports to the EU gradually declining to zero from the average rate of 9.6 per cent in 2020. Approximately at the same time, Bangladesh after graduation and a three-year transition period will face a tariff increase from zero to about 12 per cent, if it encounters the safeguard measures under the new EU GSP proposal 2023-34.*

**Figure 20: Tariff implication on apparel products for Bangladesh and Vietnam in the EU market**




Source: Authors' estimates based on the tariff schedule in EVFTA.

There are several other negotiations ongoing including the India-EU FTA and EU-Indonesia FTA. If they materialize, these are also expected to cause trade diversion away from non-members and towards FTA partners. Similarly, any bilateral or multilateral FTAs of other countries with major trading partners could weaken Bangladesh's competitiveness.

[10] It is, however, important to highlight that Vietnam will need to meet the 'double-stage' transformation RoO to benefit from apparel tariff preferences under the EVFTA. Due to limited backward linkages as reflected in its high dependence on textile imports from China, Vietnamese firms will have to add substantially more local value-added content to benefit from the EU trade deal.

### 3.3 The EU Green Deal and Carbon Border Adjustment Mechanism

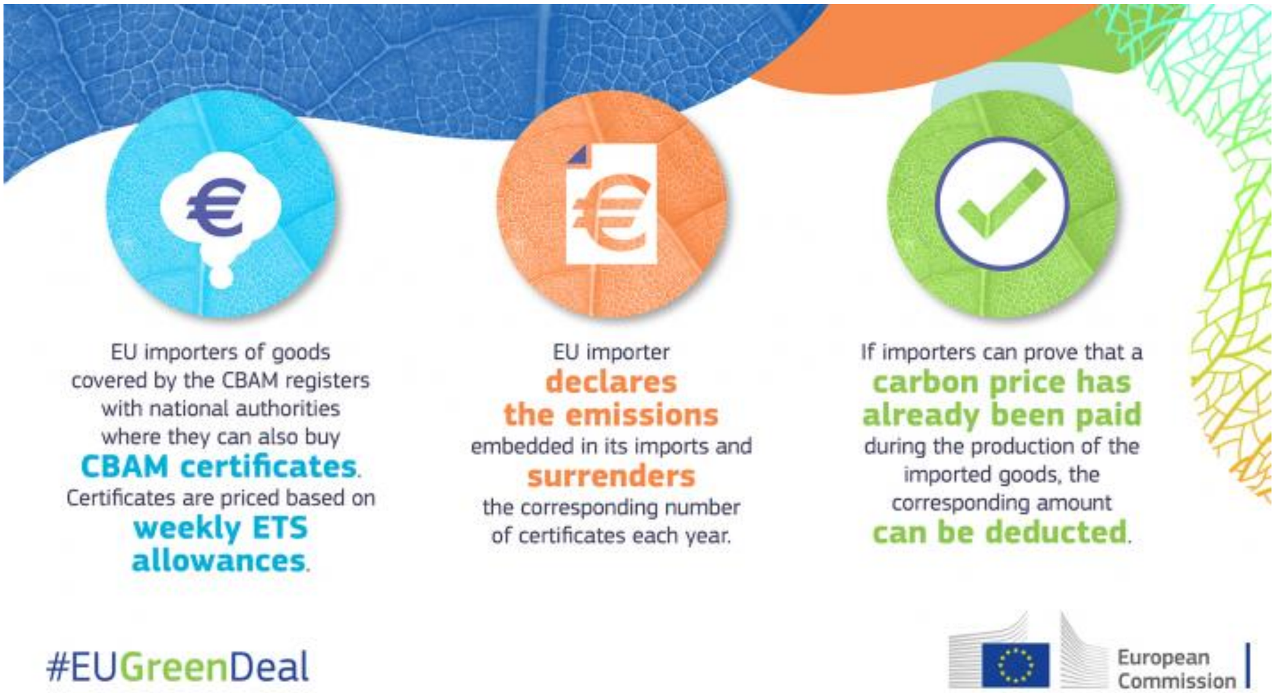
The global greening initiatives have seen a major paradigm shift in recent years as many economies have undertaken unprecedentedly bold commitments to reducing greenhouse gas (GHG) emissions and adopting low-carbon sources for energy supply to align themselves with the objectives of the Paris Agreement.[11] The return of the US to the Paris Agreement in 2021 (after withdrawing in 2020) has brought a renewed impetus as it along with the EU and UK are now leading the race on targets amongst the world's advanced economies. The greening drive is firmly set to bring about a rapid transformation of international trade and investment regimes. As the advanced economies undertake bold emission reduction targets, they aim to redesign their trade policies for tackling carbon leakage to protect the competitive advantage of their domestic sectors and in the process reduce global emissions. While the disruptions in energy supplies due to the Russian-Ukrainian war appear to have prompted some rethinking about a fast transition towards renewables, the medium- to long-term ambition of reducing GHG emission in the developed countries remains solid.

One such major development is the EU Green Deal, which intends to make the EU a carbon-neutral market by 2050. The deal aims to develop a CBAM to internalize the cost of $CO_2$ in both domestically produced and imported goods, with the objective of making the system compatible with principles of the World Trade Organization (WTO) in dealing with all trading partners equally (non-discrimination) and treating imported and locally produced goods equally (national treatment).

Since 2005, the EU has maintained an ETS to reduce GHG emissions for high carbon-emitting sectors based on the cap-and-trade principle. Under the CBAM framework, the EU wants to price the embedded carbon content in imports which will be equivalent to the price of CO2 faced by domestic firms under the EU ETS. Conversely, if non-EU exporters can establish that they have already paid a price for the carbon used in the production of their goods, the corresponding charges will be deducted from EU carbon taxes on imports (Figure 21). The proposed CBAM will initially apply only to a selected number of goods at a high risk of carbon leakage, namely in the five categories of cement, iron and steel, aluminium, fertilizers, and electricity, and will be operational from January 2023. Additional sectors are likely to be brought under coverage at later phases. In the transitional period of 2023-25, importers will have to report emissions embedded in their goods without paying a financial adjustment. From 2026 onwards, EU importers will have to pay for CBAM certificates.

[11] The Paris Agreement, adopted at the 21st Conference of the Parties of the United Nations Framework Convention on Climate Change in 2015, sets out targets and actions for climate change mitigation, adaptation, and finance.

**Figure 21: The initial operational framework of the CBAM**




Source: https://ec.europa.eu/taxation_customs/green-taxation-0/carbon-border-adjustment-mechanism_en

Both the European Council and Parliament have adopted their positions on the Commission's proposal for a CBAM.[12] The main changes to the Commission's original proposal in light of the amendments proposed by the European Parliament and the Council are discussed below and in Table 2:

***Implementation timeline***: The European Commission proposed that the CBAM tax will apply from January 1, 2026, following a three-year transition period beginning in January 2023. From January 2026, EU importers will have to purchase CBAM certificates for their imported products. The number of CBAM certificates will correspond to embedded emissions of their imports and mirror the ETS price. The Commission proposes the CBAM be implemented gradually, and the free allowances made under EU ETS will phase out over 10 years with a linear 10-percentage-point reduction rate. Both the European Parliament and the Council agree on the transition period. But the European Parliament proposes the gradual implementation of the CBAM beginning in 2027, one year later than the Commission's proposal, and full implementation beginning in 2032. By this time the free allowances are completely phased out. On the other hand, the Council supported the Commission's proposal to implement and completely phase-out during 2026-2035. Both the Parliament and Council propose different phase-out rates. The phase-out of free allowances would be slower at the start and faster toward the end.

***Sectoral coverage***: The Commission proposed that the CBAM should initially cover five sectors with a high risk of carbon leakage, namely cement, iron and steel, aluminium, fertilizers, and electricity, with the possibility of expanding the scope at a later period. The Council agreed with the Commission's proposal, while the Parliament has proposed to broaden the scope to include organic chemicals, plastics, hydrogen, and ammonia. Gradually, the coverage should be extended to cover all sectors under the EU ETS.

[12] On 15 March 2022 the European Council adopted its general approach on the CBAM. On 22 June 2022, the European Parliament adopted its position on the regulation.

The Council supported the Commission's proposal to apply CBAM to direct emissions, with the possibility of including indirect emissions at a later stage. On the other hand, the Parliament proposes to expand its scope to cover direct and indirect emissions, defined as GHG emissions from the production processes of goods and electricity consumed during the production process. The amount of CBAM certificates purchased by the importer would thus be determined by the carbon intensity of the electricity grid used by the foreign producers. All institutions agree that it should be investigated whether emissions related to import transportation can be covered by the CBAM in the future.

***Export rebates***: The Parliament proposes an amendment that EU producers should receive free allowances for producing goods for export to non-EU countries without any carbon pricing mechanism similar to the EU ETS.

***Administration of the CBAM***: The Commission proposed that the CBAM will be administered by the national authorities of 27 EU Member States. However, both the Parliament and the Council have sought to ensure greater centralization of the CBAM. Instead of having authorities in each Member State, the European Parliament proposes the establishment of a separate CBAM authority. The Council, on the other hand, proposes to create a central EU registry of CBAM declarants rather than having a separate registry for each Member State. But respective authorities in each Member State will be responsible for CBAM implementation.

**De minimis *exemption***: The Council proposes a *de minimis* rule that exempts shipments of less than €150 from the CBAM in order to reduce administrative complexity. The Commission's proposal, as well as the European Parliament's position, do not include the *de minimis* mechanism.

***CBAM revenues***: The Parliament clarifies that CBAM revenues must fall under the EU budget and be a new so-called "own resource" of the EU. The revenue will be used to support climate mitigation and adaptation in the LDCs, including their efforts towards the de-carbonization and transformation of their manufacturing industries.

**Table 2: Main revisions/comments suggested by the European Parliament and European Council to the Commission's proposal**[13]

| Focus point | European Commission proposal | European Parliament position | European Council position |
|---|---|---|---|
| **Implementation timeline** | Transitional phase: 2023-2025<br>Implementation period: 2026-2035<br><br>Phase out of free allowance: gradual phase at 10 percentage points each year. | Transitional phase: 2023-2026<br>Implementation period: 2027-2032<br><br>Phase out of free allowance: 7 percentage points reduction in 2027, 9 in 2028, 15 in 2029, 19 in 2030, 25 in 2031, and 25, down to 100% phase out in 2032. | Transitional phase: 2023-2025<br><br>Implementation period: 2026-2035<br><br>Phase out of free allowance: Non-linear phase out during 2026-35: lower rate at the start and faster towards the end. |
| **Sector coverage** | Cement, iron and steel, aluminium, fertilizers, and electricity, with the possibility of broadening the scope after it goes into effect. | Expansion of the scope to include organic chemicals, plastics, hydrogen, and ammonia and gradually cover all sectors under the EU ETS. | Agrees with the Commission's proposal. |
| **Emission coverage** | Direct emission only. | Indirect emissions will be covered as well. | Investigate to include indirect emissions. |
| **Export rebate** | Does not include a rebate of carbon costs when EU goods are exported. | Green export rebate mechanism. | --- |
| **CBAM Revenues** | --- | CBAM Revenue accrues to the EU budget (own resources), but at least commensurate increase in support for LDC decarbonization. | --- |
| **Administration** | Separate authority under each Member State. | Centralized administration through a central CBAM authority. | Decentralized governance by 27 Member States' authorities, but one central registry of authorized CBAM declarants. |
| **De minimis exemption** | The *de minimis* mechanism was not included in the Commission's proposal. | A *de minimis* rule that exempts shipments of less than €150 from the CBAM. | --- |

Source: Authors' summary based on European Commission,[14] European Parliament (2022)[15], and European Council (2022)[16].

[13] Information obtained from: https://data.consilium.europa.eu/doc/document/ST-13063-2022-INIT/en/pdf

[14] https://data.consilium.europa.eu/doc/document/ST-13063-2022-INIT/en/pdf

[15] Amendments adopted by the European Parliament on 22 June 2022 on the proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism (COM(2021)0564 – C9-0328/2021 – 2021/0214(COD)). https://www.europarl.europa.eu/doceo/document/TA-9-2022-0248_EN.html#ref_1.1.and, https://www.europarl.europa.eu/legislative-train/theme-a-european-green-deal/file-carbon-border-adjustment-mechanism#:~:text=On%2022%20June%202022%2C%20the,emissions%20trading%20system%20by%202032.

[16] Draft regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism - General approach. https://data.consilium.europa.eu/doc/document/ST-7226-2022-INIT/en/pdf

At the time of completing this paper, the European Parliament and European Council reached a provisional agreement on the terms of the EU's CBAM, covering the following modifications:[17]

- The CBAM will initially cover iron and steel, cement, aluminium, fertilisers and electricity, as proposed by the Commission, and extended to hydrogen, indirect emissions under certain conditions, and certain precursors, as well as to some downstream products such as screws and bolts and similar articles of iron or steel.

- The Commission shall assess whether to extend the scope to other goods at risk of carbon leakage, including organic chemicals and polymers, with the goal to include all goods covered by the ETS by 2030.

- The Commission shall assess the methodology to capture indirect emissions, and the possibility to include more downstream products.

- The CBAM will enter into force in its transitional phase from 1 October 2023 where the importer will be reporting the amount of direct emission embedded into their imported products, without making any financial payments or adjustments.

- The timeline for the transition period and full phase-in of the CBAM will be defined in the revised ETS rules which are under negotiation.

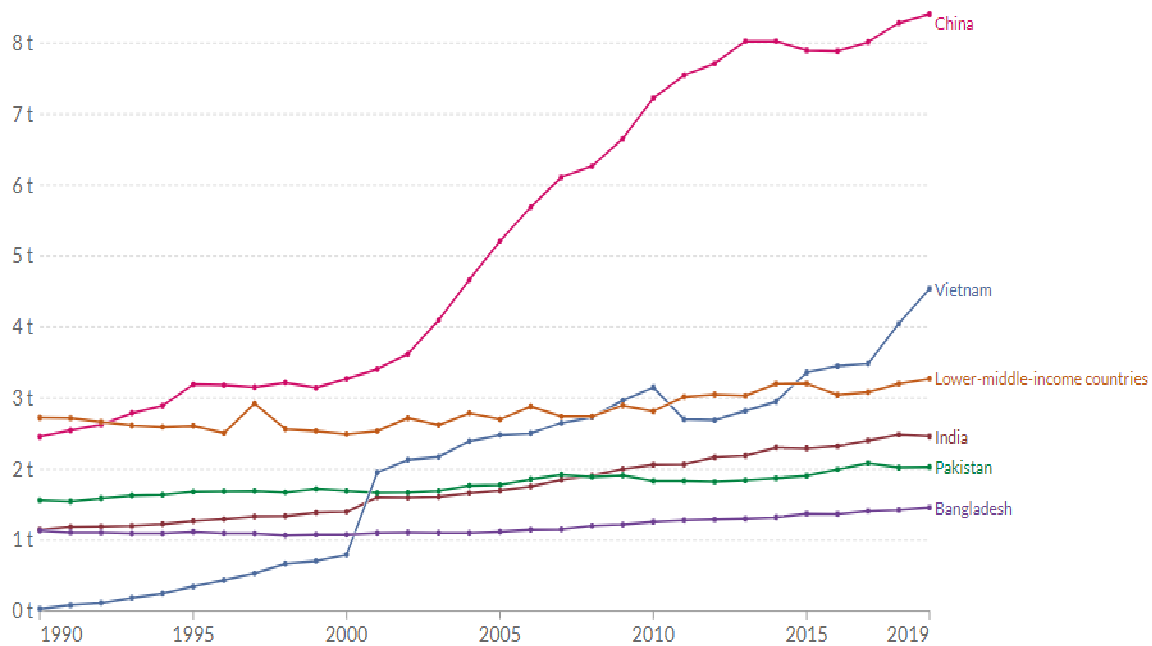
The CBAM is closely linked with the agreement on the reforms of the EU Emission Trading System (ETS), the latter is under negotiation in trilogue, tripartite meetings on legislative proposals, between the co-legislators. The European Parliament and the Council will have to formally adopt the agreement before it can enter into force. The new law will come into force 20 days after its publication in the EU Official Journal.

**Bangladesh's position in the global carbon-reduction drive**

Bangladesh is one of the least carbon-emitting countries in the world. The per-capita GHG emission stood at 1.46 tonnes of $CO_2$ equivalent ($CO_2e$) in 2019, much lower than the lower-middle-income countries' average of 3.3 tonnes. The corresponding figures are 8.4 in China, 2.5 in India, and 3.81 in Vietnam (Figure 22).

[17] Information obtained from: https://www.europarl.europa.eu/news/en/press-room/20221212IPR64509/deal-reached-on-new-carbon-leakage-instrument-to-raise-global-climate-ambition, accessed on 20 December, 2022.

**Figure 22: Per-capita greenhouse gas emissions**




Source: CAIT Climate Data Explorer via Climate Watch OurWorldInData.org/co2-and-other-greenhouse-gas-emissions • CC BY
Note: Greenhouse gases are weighted by their global warming potential value (GWP100). GWP100 measures the relative warming impact of one molecule of a greenhouse gas, relative to carbon dioxide, over 100 years.

Bangladesh signed the 2015 Paris Agreement on climate change, including the target of keeping the global temperature increase below 2°C or at 1.5°C above pre-industrial levels. It submitted its updated Nationally Determined Contribution (NDC) providing commitments to reduce GHG emissions. In the updated NDC, Bangladesh commits to unconditionally reduce its GHG emission by 6.73 per cent (27.56 megatonnes of CO2e) from the business-as-usual scenario by 2030. Subject to technology and knowhow transfer and finance and investment support from the international community, the country intends to reduce GHS emissions by an additional 15.12 per cent (61.9 MtCO2e).

Bangladesh's NDC commitments and actions for reducing carbon emissions are far from ambitious compared to some other countries. China has committed to reducing $CO_2$ emissions per unit of GDP by 60 to 65 per cent (from the 2005 level) by 2030, while India intends to reduce the emissions intensity of GDP by 33 to 35 per cent. Vietnam, on the other hand, has committed to a modest target of reducing GHG emissions by 9 per cent unconditionally, rising to 27 per cent subject to receiving international support in the form of technology transfer, low-cost international finance, and capacity building.

Bangladesh's major comparators have either already established or are in the process of developing carbon markets locally. China has launched its carbon market which is being regarded as the world's largest.[18] Vietnam has issued a decree titled Providing Regulations on Reduction of Greenhouse Gas Emissions and Protection of the Ozone Layer.[19] The decree specifies that the country will start a pilot carbon market operation, followed by a fully operational carbon market to be formally launched in 2028. India is also in the process of developing a domestic carbon market, however, no specific dates have been announced. On the other hand, there exists no effective regulations in Bangladesh on carbon emissions by the industries, and nor any carbon tax initiative.

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[18] China's national ETS came into effect on 1 February 2021 with compliance obligations for entities in the power sector emitting over 26,000 tCO2 annually from the 2013-2019 period. The compliance cycle started on 1 January 2021 and covers an estimated 2,225 entities, making it the world's largest ETS. The national market covers around 30 per cent of national emissions or around four billion MtCO2. For more information, see https://www.nature.com/articles/d41586-021-01989-7.

[19] Decree No. 06/2022/ND-CP Providing Regulations on Reduction of Greenhouse Gas Emissions and Protection of the Ozone Layer. https://monre.gov.vn/VanBan/Lists/VanBanHanhChinh/Attachments/282/06-nd.signed.pdf

**Table 3: Carbon reduction targets of selected countries**

| Countries | NDC[20] targets | Measures to reduce carbon |
|---|---|---|
| **Bangladesh** | -Unconditionally reduce its GHG emissions by 6.73% by 2030 compared to the business-as-usual (BAU) scenario.<br>-Conditionally reduce GHG emission further, by a total of 15.12%. | -The 8th Five Year Plan of Bangladesh has proposed to introduce a green tax.<br>-Promoting green investment through fiscal and financial incentives.<br>-155 RMG factories certified as green by the US Green Building Council's Leadership in Energy and Environmental Design; 500 more factories are in the process of certification. |
| **China** | -To lower $CO_2$ emissions per unit of GDP by 60 to 65% by 2030 from the 2005 level.<br>-To increase the share of non-fossil fuels in primary energy consumption to around 20%.<br>-To increase the forest stock volume by around 4.5 billion cubic meters relative to 2005. | -Net zero GHG emissions by 2060.<br>-To phase down the production and consumption of chlorodifluoromethane (a greenhouse-gas hydrochlorofluorocarbon also known as HCFC-22) for controlled uses, with its production reduced by 67.5% from the 2010 level by 2025, and to achieve effective control on emissions of trifluoromethane (another a greenhouse-gas hydrochlorofluorocarbon, known as HFC-23) by 2020.<br>-Action Plan of Industries Addressing Climate Change (2012-2020).<br>-Formulating carbon-emission control measures and action plans in key industries.<br>-Started ETS in 2021. |
| **India** | -To reduce the emissions intensity of GDP by 33-35% by 2030 from the 2005 level. | - Passed the Energy Conservation (Amendment) Bill, 2022, to achieve its climate goals.<br>-To achieve about 40 percent cumulative electric power installed capacity from non-fossil fuel-based energy resources by 2030 with the help of the transfer of technology and low-cost international finance including from the Green Climate Fund.<br>-Production linked incentive scheme to encourage manufacturing in high-efficiency modules in renewable energy.<br>-To create an additional carbon sink of 2.5 to 3 billion tonnes of $CO_2e$ through additional forest and tree cover by 2030.<br>- In the process of establishing a carbon market. |
| **Vietnam** | -Reduce GHG emissions by 9% (unconditionally) compared to the BAU scenario by 2030 with its domestic resources.<br>-Subject to international support, this contribution can be raised to 27%. | -A wider range of waste types and environmentally harmful products/goods may be subject to environmental protection taxes.<br>-The new Law on Environmental Protection proposes a concrete policy on an emissions trading system and carbon tax.<br>-Green Label Certification: eligible for a complete exemption from all export taxation.<br>-Planning to introduce tax incentives to encourage the development and use of electric vehicles. |
| **Pakistan** | -Reduce up to 20% of its 2030 projected GHG emissions subject to the availability of international grants. | -The reforestation initiative to mitigate climate change by planting 10 billion trees by 2025.<br>-The electronic vehicle policy to promote clean energy and reduce GHG gas emissions. |

Source: Razzaque and Zobair (2021).

[20] Or Intended Nationally Determined Contributions

**Implications for Bangladesh**

The EU Green Deal and other similar initiatives around the world are gradually taking shape and will foster the drive to cut GHG emissions. The anticipated changes will impact enterprises and industries that emit carbon. Therefore, it is important to assess the direct and indirect carbon emissions in exporting sectors in developing countries, identify potential impacts and take appropriate actions.

Initially, the CBAM is not expected to cause any major concern for Bangladesh as the five sectors considered for carbon taxation are not among the major exports of the country. However, it is almost certain that the coverage of border measures in the EU will expand. In the current EU proposals, LDCs and some other small island developing states are likely to be exempted from the border carbon tax. The full implementation of the CBAM will coincide with Bangladesh's LDC graduation timeline in 2026. If the coverage of CBAM is expanded to include textiles and apparel, Bangladesh could be confronted with the simultaneous challenges of post-LDC tariff hikes and CBAM charges.

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*If the coverage of the carbon border adjustment mechanism is expanded to account for the textile and clothing exports, Bangladesh will face double trouble of post-LDC tariff hikes and CBAM charges.*

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As per the EU CBAM, extra-EU exporters already subject to carbon reduction tax at the production stage will be treated differently at the border. Currently, Bangladesh does not have any carbon emission control measures. On the other hand, its major competitors including China, India, and Vietnam, have either already established or are in process of developing their domestic carbon market. The operation of carbon markets in other countries will encourage their firms to become more efficient and attract more foreign investment. If Bangladesh continues with no carbon action measures, its exporters will have to face a higher carbon tax compared to its major competitors .

## 3.4 Environmental, social, and governance compliance and implications for trade and investment

The emerging trends in global trade and investment regimes, led by the EU, seem to suggest that the future success of exports will critically hinge upon ESG compliance. ESG issues are increasingly being used by investors as a part of their analysis to spot important risks and business possibilities. ESG assets under management and bonds have increased in value and quantity recently and are generating sizable returns. Over half of the 100 largest multinational enterprises in terms of foreign assets have implemented or plan to implement internal carbon pricing systems as part of their ESG policies, according to a report by Johnson (2017). Additionally, the financial industry's mainstreaming of ESG problems is having an impact on multinational enterprises' business plans and FDI project financing. According to the FE fundinfo 2021 Financial Adviser Survey, two-thirds of advisers are investing more of their customers' money in specialized ESG fund proposals than they were previously. Within the next five years, more than three-fourths of advisers anticipate that their clients' portfolios will contain more than 25 per cent of ESG funds.

In addition to investment decisions by shareholders and stockbrokers, ESG issues are becoming ever more major components of international commerce and corporate activity as consumers' raising awareness of climate change issues is carefully taken into consideration in supply chain management issues. There is evidence that a sizable and increasing percentage of customers are emphasizing sustainable consumption. Up to 90 per cent of European consumers claim that the sustainability of items influences their purchasing decisions (Oney, 2020). Nearly one-third of American customers have been found to make some attempt to buy from companies that are committed to minimizing their environmental harm.

*Up to 90 per cent of European consumers claim that the sustainability of items influences their purchasing decisions.*

Long-term sourcing decisions increasingly take into account factors like workplace safety, labour conditions, and environmental compliance. Fashion firms and merchants are becoming more serious about the introduction of stricter environmental and ethical requirements and certifications, along with factory working conditions including workers' safety (McKinsey Institute, 2021). Many foreign customers of textiles and clothing have taken aggressive actions to commit to ambitious targets for lowering GHG emissions and their overall environmental impact as a result of the global climate change discourse (UNCTAD, 2021). ESG considerations are expected to be crucial for medium- to long-term export success due to pressure from numerous international campaigners and advocacy groups, pushes from governments and regulators in the importing countries, and growing consumer awareness of workers' rights and ethical sourcing.

Numerous businesses are incorporating sustainability into their products and processes in response to consumer demand. This includes many retail and fashion giants. Global multinational businesses operating in poor countries have increased their efforts to ensure sustainability and decarbonization of products since the start of the epidemic, according to data from a World Bank poll. The EU ESG goals emphasize greater transparency in the market, fulfil the need of asset managers and investors, channel capital flows towards more sustainable investments, and assist the combat against ESG washing (i.e., misleading claims regarding ESG credentials). If ESG in Bangladesh is properly managed, there is a significant chance of establishing long-term trade with the EU and attracting international investment.

The emerging trend seems to suggest that Bangladesh's export-oriented RMG industry's future performance will be largely dependent on ESG compliance. With many green garment factories, Bangladesh has already taken a considerable stride forward. However, the RMG industry has several additional ESG challenges, such as excessive water usage, weak labour standards, and inadequate waste management, which might continue to harm export prospects unless immediate and comprehensive remedial actions are taken. While Bangladesh's largest and most significant export industry, the RMG sector, is under scrutiny, ESG standards for other sectors (both import-competing and export-oriented) are considered to be much worse. In such a situation, unless considerable consideration is paid to enhancing ESG compliance, attracting foreign investment, and increasing exports—which Bangladesh desperately needs given its impending LDC graduation—would be a daunting prospect.

*Unless considerable consideration is paid to enhancing ESG compliance, attracting foreign investment and increasing exports would be a daunting prospect given the shifting global trade and investment regimes.*

**Box 1: Vietnam's ESG drive and key initiatives**

The ESG practices in Vietnam have improved dramatically in recent years, owing mostly to the government's intensified efforts to encourage ESG-related activities and investors' growing interest in sustainable investment. Vietnam has put climate change on its ESG agenda. At the United Nations Climate Change 26th Conference of the Parties in 2021, Vietnam pledged to attain net-zero carbon emissions by 2050, halt deforestation by 2030, and phase out coal-fired power plants by 2040. Recently, the Ministry of Natural Resources and Environment collaborated with the International Finance Corporation and Citibank to seek assistance and resources to help it achieve its goals.

Major private-sector investment firms have pledged to adhere to ESG investing by adopting the United Nations Principles for Responsible Investment. The growing interest in ESG criteria among investors, particularly international investors, has increased the private sector's participation. Companies from several industries have vowed to address ESG issues in their operations.

Some major initiatives both in the public and private sectors have been taken to comply with the ESG agenda. For instance, SCG, a construction conglomerate, has committed to investing more than VND47,000 billion (approximately US$2 billion) to improve its production process and apply high technology in business in order to meet the 20% reduction target in GHG emissions by 2030 and the net zero emission target by 2050; international bank HSBC has committed to arranging up to US$12 billion in sustainable financing for Vietnam by 2030, with a stated 10% completion rate as of May 2022; the stock exchanges of Ho Chi Minh City and Hanoi have developed the Vietnam Sustainability Index to recognize and promote best ESG practices followed by publicly traded companies in Vietnam; Vinamilk, a significant publicly traded firm, has made ESG a critical aspect in attaining long-term growth; Dragon Capital, a reputable investment firm, has accepted the United Nations Principles for Responsible Investment in order to improve its risk-adjusted performance; and Hoa Phat, a leading industrial manufacturing business in Vietnam, invests in generating energy from the massive quantity of excess heat generated during the steelmaking process, which covers up to 80% of the electricity required for steel production.

**A market for carbon trading**: To combat climate change and reduce carbon emissions, Vietnam has taken initiative to establish a carbon market. The government intends to build and pilot the domestic carbon market between 2025 and 2027, with the goal of having it operational in 2028 and connected to regional and global carbon markets by 2030.

Besides protecting the environment, Vietnam has provided a special focus on social factors. In particular, the country has a specific law on the working conditions of employees that clearly mentions the salary, working hours, overtime, occupational health and safety, and social, health, and unemployment insurance. Other social factors include the following:

- **Diversity and inclusion**- Gender equality is highly promoted, which implies that male and female employees are to be treated equally in terms of recruitment, employment, training, working hours, salary, and advancement. Discriminatory practices may result in several administrative penalties for the company. Furthermore, discriminatory behaviour based on gender that prohibits someone from working may be considered unlawful under the Penal Code.

- **Forced labour**- Labour coercion (defined as using force, threatening to use force, or using other tricks to coerce a worker to work against their will); workplace maltreatment or sexual harassment; and taking advantage of an apprenticeship or trade-training programme to profit from or exploit an employee are all prohibited by law. However, a breach of such prohibitions may result in administrative or criminal consequences for the employer, depending on the severity of the infraction.

- **Child labour**- The Labour Code allows the work of children under the age of 18, with varying levels of protection for three age groups: under 13, 13 to under 15, and 15 to under 18. Record-keeping and reporting obligations, work-hour limits, and job-type restrictions are all applicable.

- **Sexual harassment**- Enterprises may discharge an employee for sexual harassment as prescribed by the enterprise's internal labour standards. However, an employee may unilaterally cancel their labour contract without providing advance notice if they are sexually harassed at work.

- **Privacy and data protection**- Current data privacy regulations usually demand the approval of the data owner for any collection, use, or disclosure of personal data, and data processors must establish managerial and technical safeguards to protect personal data. The government presented a draft regulation on personal data protection in early 2021, proposing fairly severe and established data privacy standards.

Good governance is an important criterion of ESG and Vietnam puts much emphasis to ensure governance factors. These include:

- **Anti-bribery and corruption**- The country has effectively incorporated the Anti-Bribery and Corruption Law (which establishes basic anti-bribery and corruption provisions) and the Penal Code.
- **Executive remuneration**- ESG considerations for executive remuneration include the inclusion of sustainability targets.
- **Disclosure of information and ESG report**- According to Vietnamese law, public firms must publish ESG performance in their annual reports, and private enterprises are required to file quarterly reports to the authorities, including water and energy use, employee-related policies, green capital market operations, and community contributions.
- **Board diversity and inclusion**- This refers to the diversity of a board of directors' membership in terms of skills, ages, genders, cultures, nationalities, and independence from the company's internal constraints. In some instances, a board of directors must have independent directors under Vietnamese law (e.g., one-fifth of the board directors of an unlisted public corporation must be independent).

## 3.5 EU corporate sustainability and supply chain regulations

In February 2022, the European Commission adopted a proposal for a Directive on Corporate Sustainability Due diligence. Its main objective is to promote human rights and environmental protection, ensure a level playing field for EU businesses, and eliminate fragmented regulatory supply chains' due diligence enacted by France and Germany. The directive requires EU companies, as well as some non-European companies doing significant business in Europe, to evaluate their actual and potential impacts on human rights and the environment throughout their operations and down their supply chains, and to take steps to prevent, mitigate, and remedy any identified human rights and environmental harms.

The due diligence is applicable for EU companies with at least 500 employees and a global net turnover greater than €150 million, or non-EU companies that generate a turnover of at least €150 million in the Union each year. It also applies to EU companies operating in sectors at high risk of human rights and environmental concerns, including textiles and leather manufacturing, agriculture, forestry, fisheries, minerals, and mining, with at least 250 employees and that generate a turnover of more than €40 million. The due diligence also applies to non-EU companies in both categories, but their turnover threshold is only applied to revenues generated in the EU.

According to the directive, companies are responsible for ensuring human rights and environmental protection within the entire supply chain. Forced labour, child labour, inadequate health and safety at work, worker exploitation, environmental violations such as GHG emissions, pollution, or the destruction of biodiversity or ecosystems will be prevented under the directive. Covered companies are required to conduct human rights and environmental due diligence to identify current and potential adverse effects from their operations and from their established business relationships. They must then take action to stop, lessen, or prevent those adverse effects. These include consulting the affected parties, developing codes of conduct, adopting rules and environmental and human rights due diligence policies, and investing in internal infrastructure to assure compliance. Companies will also be required to have their business strategies compatible with the limiting of global warming to 1.5°C, aligning with the Paris Agreement. The European Commission estimated that the directive will initially apply to approximately 13,000 EU companies and about 4,000 non-EU companies. Micro companies and small and medium enterprises are not directly affected by the directive. However, they can be indirectly affected as large companies will also oblige small and medium-sized enterprises to review their supply chains and obtain assurances of compliance with due diligence requirements.

The European Parliament and the Council will now review the proposal. There is no specific timeline for adoption. Once the new regulations are adopted by the European Parliament and the Council of the EU, member states of the EU will have two years to enact them into their domestic legislation.

The EU directive follows the supply chain laws adopted by France and Germany. The German Federal Parliament enacted Supply Chain Due Diligence Act in June 2021. The main objective of Germany's new supply chain law is to build an obligation for firms and businesses to conduct human rights and environmental due diligence at all tiers of their supply chains. Businesses that fail to abide by the supply chain law's requirements may face civil liability and be subject to administrative fines, while victims of human rights abuses would be entitled to file damage claims before German courts. The law will come into force in January 2023.

In 2023, this law will be effective for all German-based companies with more than 3,000 employees, or German-registered branches of foreign companies with more than 3,000 employees. However, by 2024, this law will be applicable to all German-based companies with more than 1,000 employees, or German-registered branches of foreign companies with more than 1,000 employees. This covers temporary workers with a tenure of more than six months, as well as staff deployed abroad. All companies that are direct and indirect suppliers and are part of the German supply chain will be affected. All eligible companies and firms will need to ensure that social and environmental standards are observed at all tiers of their value chain, including suppliers of all sizes and in other countries.

The Duty of Vigilance Act of France was enacted in March 2017. It requires France-based companies with 5,000 or more employees in the country, or 10,000 or more worldwide, to establish a "plan of vigilance" for identifying risks to human rights, health and security, or environmental violations within their global supply chains. It requires businesses to develop a risk map, methods for reviewing partners and subsidiaries, actions to mitigate risks and serious violations, and a mechanism for receiving alerts of violations from workers and organizations.

The supply-chain laws in the EU and individual member states may affect businesses in the developing countries that supply to the EU. Compliance with the EU due diligence is applicable for all "established business relationships", direct or indirect along their entire supply chain. It is not limited to direct suppliers. Under this clause, companies will have to monitor their entire supply chain to check whether suppliers are violating environmental, climate, or human rights. This also applies to those outside of Europe. Companies may request particular due-diligence papers from suppliers and sub-contractors to ensure the standards are being met. Therefore, non-EU businesses may have to comply with the directive. According to a study by the Institute of German Economy, to comply with the supply chain law about one-fifth of German companies are planning to contract with suppliers in countries with higher human rights, labour, and environmental standards.[21] Another study by the same institute indicates that France's Duty of Vigilance Act will likely be associated with a lower level of trade. The EU countries are important export destinations and a major source of investment for many emerging developing countries including Bangladesh. Therefore, compliance with the supply chain laws in the EU is likely to affect export and investment in Bangladesh.

### 3.6 Geo-economics and geo-political factors

The geo-economic and geo-political factors are becoming critical in international trade and investment. Due to heightened tensions, the US is attempting to decouple itself from China in respect of the two countries' erstwhile symbiotic trading and investment relationship, while other powerful nations are being influenced by the US's policy stance. Given the strong political and economic ties with the US, the EU approach toward China is also shifting. China is the largest trade partner of the EU. The bilateral trade between the EU and China stood

[21] https://www.gisreportsonline.com/r/supply-chain-regulation/

at $865 billion in 2021. Of this, the EU imported more than $600 billion, making China the largest non-EU supplier to the bloc.

The EU-China bilateral relationship is evolving. The EU referred to China as a partner for cooperation and negotiation, an economic competitor, and a systemic rival in 2019.[22] This description was reaffirmed by the EU in its Strategic Compass in March 2022. This perception of China appears to be far from unambiguous and reflects an unsettled policy stance. The issues that strain the EU-China relationship include: the US's hard-line approach in dealing with China; China's alleged human rights abuse; economic coercive measures; and the Chinese position in the Russian-Ukrainian war.[23] As it appears now, while the EU is critical of China's human rights record, governance structures with too many state interventions, and foreign policy approaches, it still wants to maintain and expand business ties with China, which is the second-largest economy and largest trading nation in the world. Any deterioration in trade and economic relationship between the EU and China has huge worldwide repercussions due to the sheer volume of trade between the two (Maddock, 2022).

The EU had also requested China to use its substantial influence over Russia to secure an early ceasefire in March 2022, the creation of humanitarian passageways, and the avoidance of any threats of Russia's aggression against Ukraine escalating further, which did not materialize. The energy price hikes in the aftermath of the Russian invasion of Ukraine have severely affected European countries. Against this backdrop, the European Commission has introduced a comprehensive set of policies that could affect its relationship with China (Ardissino and Freymann, 2022).

This deteriorating relationship is affecting a long-awaited ambitious bilateral trade agreement. The Comprehensive Agreement on Investment, which China and the EU agreed to on 30 December 2020, was characterized by the European Council as a values-based investment relationship underpinned by sustainable development principles.[24] The ratification process, however, appears to be in a deadlock after the initial agreement in principle. By allowing EU businesses considerable access to China's internal market, the agreement was dubbed as one of the most ambitious agreements that China had ever concluded. China agreed to remove quantitative limits, forced technology transfers, equity caps, and joint venture requirements in different industries where most of the EU companies in China are operating. Additionally, it was supposed to safeguard FDI from the EU in China. China would also meet the EU's openness in the manufacturing sector, where half of EU FDI is invested—a concession that had never before been made in Chinese trade or investment accords (European Commission, 2020).

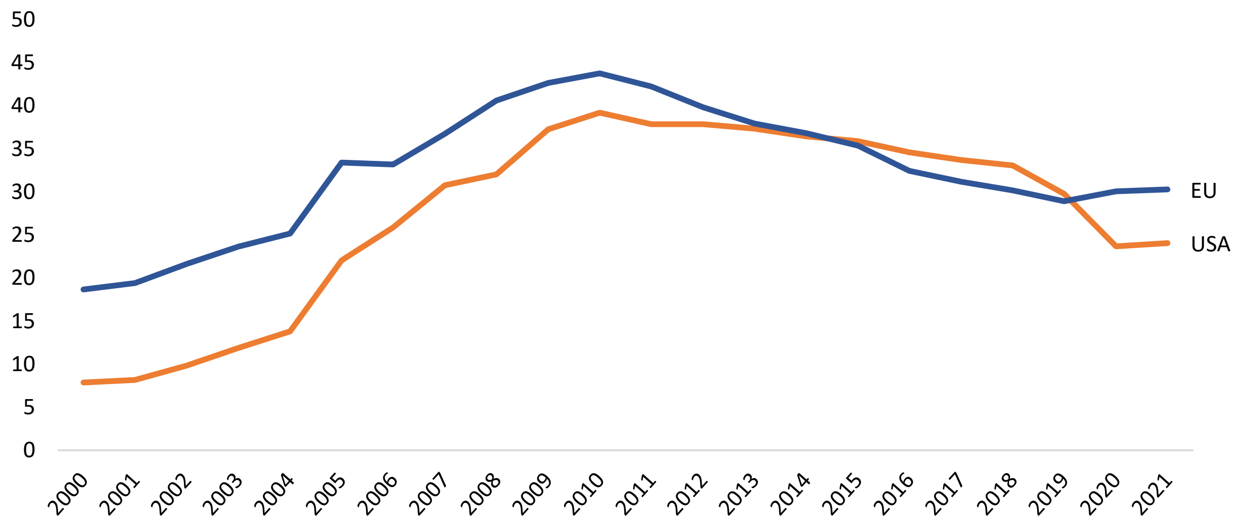
In the policy decisions of the EU, the US is influential in its strategic partnership with Europe. The US launched the Indo-Pacific Economic Framework as a possible counter to China's influence in the Asia-Pacific region. While this framework does not ensure free trade deals for its members, it has managed to intensify tensions between the US and China, affecting other countries in the process. The US and its allies are now trying to diversify manufacturing and supply sources away from China.

The geopolitical rivalry between Western developed countries and China will likely have major implications that the global economies will have to grapple with. While the overall consequences for individual economies are far from clear at this stage, shifts in supply chains arising from the decoupling efforts of the US and EU could mark profound changes in trade prospects. For instance, China's shares of the EU and US apparel markets have been on the decline over the past decade (down by 14 and 16 percentage points, respectively, as shown in Figure 23, and could fall at a faster pace in the coming years). This should open up new market opportunities for other suppliers. While Bangladesh, taking advantage of duty-free market access, has been able to take full advantage of China's reduced share in the EU, it is Vietnam that could make the most gains in

[22] https://www.eeas.europa.eu/sites/default/files/documents/EU-China_Factsheet_01Apr2022.pdf
[23] EU-China Relations Factbook, April 2022. https://www.eeas.europa.eu/eeas/eu-china-relations-factsheet_en
[24] https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2541

the US market.  To some extent, China is also moving away from low value-added items to technologically more sophisticated products. It can, therefore, make room for others in low-skill intensive manufacturing exports. This tendency can be augmented by rising geopolitical tensions. However, if the global trade and investment climate becomes uncertain as a result of these developments, most global economies could suffer. This became evident immediately prior to the onslaught of the COVID-19 pandemic when US-China tariff wars caused global trade to plunge with most countries recording falling export revenues.

**Figure 23: Chinese apparel market shares in the EU and US (%)**




Source: Authors' analysis using data from Eurostat and OTEXA.

## IV. Way forward for Bangladesh

It cannot be overemphasised that the EU will continue to remain the most important trade and development partner of Bangladesh. The export success that Bangladesh has seen until now has largely been due to LDC-specific trade preferences granted by the EU. The impending policy shifts arising from the upcoming LDC graduation could be a defining feature or tipping point to a changed bilateral trade and economic cooperation regime. Policymakers and stakeholders need to have a proper appreciation of the approaching critical juncture of this relationship. It is important to develop a national-level consensus on the options for dealing with the emerging issues so that Bangladesh can continue to sustain a productive and beneficial bilateral relationship.

### Developing a long-term strategy and action plan constitutes a priority for strengthened Bangladesh-EU cooperation.

Given the unwavering importance of the EU as a source of export earnings, foreign investment, and development assistance, Bangladesh must develop a strategy to deal with the emerging issues discussed above in a bid to promote the bilateral relationship further, even under changing circumstances. The strategy and action plan should be developed based on proper assessments including the adjustment measures that need to be undertaken.

### Bangladesh must effectively engage with the EU for securing favourable terms in the post-LDC graduation period.

Under the proposed EU GSP regime for 2024-34, Bangladesh after its LDC graduation may be able to access GSP+ depending on the ratification and effective implementation of the 32 specified international conventions. However, even then, as discussed above, Bangladesh's apparel exports could be subject to safeguard measures, thereby not getting any preferences at all. An assessment by the WTO and Enhanced Integrated Framework (EIF) in 2020 estimated that post-graduation Bangladesh could see a tariff rise of 11.2 percentage points, causing a huge 26.3-per-cent decline in exports in the EU. Accessing GSP+ for apparel products would thus be a priority. Bangladesh must take measures to complete the process of ratification of the international conventions which have not yet been ratified. It is also extremely important to effectively engage with the EU to obtain a waiver from safeguard measures on apparel products.

Recently the UK, in its new GSP called the Developing Countries Trading Scheme (DCTS), removed the requirements to comply with the international conventions as a precondition for non-LDC developing countries to access the most generous preferences. Furthermore, the UK will also not impose any safeguard measures on apparel imports from graduated former LDCs. Considering this example, the EU can be requested to also abolish the safeguard provisions from the exports of graduated LDCs.

Graduating LDCs face stringent RoO requirements to benefit from any duty-free access. With limited productive capacities, it might be difficult for Bangladesh to comply with the requirement of double-stage transformation in textile and clothing products. For other products, the RoO requirement of 50-per-cent value addition will be an extremely arduous task for graduated LDCs. Therefore, Bangladesh along with other graduating countries should collectively request the EU to apply for EBA-type liberal RoO terms for a longer transition period.

### Bangladesh should consider securing a full-fledged free trade and investment agreement with the EU for maintaining the current market access for exports and attracting investment.

The proposed EU GSP could bar Bangladesh's apparel exports to receive any tariff concessions after LDC graduation (due to the safeguard measures mentioned above). Furthermore, the EU GSP proposals stipulate that non-LDC upper middle-income countries will not be eligible for any tariff preferences. Bangladesh aspires to become an upper-middle-income country by 2031; if this is achieved, the scope of GSP preference will cease to exist. In this regard, establishing an FTA with the EU is the only way to continue duty-free preferential market access. Given its consistent economic growth performance, which places Bangladesh among the largest 30 economies, most trading partners will regard it as an attractive partner for a trade agreement. Striking FTAs with such a trade partner as the EU is an enormously challenging task requiring massive preparation and many years to succeed. However, such a strategy can help undertake significant reforms promoting domestic competitiveness, while at the same time, if FTA negotiations are successful, retaining EU market access in the long term.[25]

### Bangladesh must take time-bound actions for ensuring conformity with international conventions/standards.

Implementations of international standards are becoming more widespread than ever as a requirement for preferential market access. Bangladesh must ratify and effectively implement 32 international conventions to qualify for GSP+ in the EU after graduation from the LDC category. As of the time of writing, Bangladesh has ratified 20 of the conventions and acceded the remaining 12 awaiting ratification. It is therefore critical to take necessary steps to complete the ratification process for the remaining ones, and effectively implement all.

A delegation of the International Trade Committee of the European Parliament recently visited Bangladesh to observe how it is preparing to comply with international conventions for the transition from EBA to GSP+ trade preferences. The delegation raised concerns about labour rights, social and environmental standards that are applied to GSP+ beneficiary countries. It suggested amendments to the Bangladesh Labour Act, Labour Rules and Export-Processing Zone Labour Laws in line with International Labour Organization (ILO) conventions, establishing an action plan to eliminate child labour by 2025, combating violence against workers, increasing success-rate of trade union registration applications, eliminating the backlog of cases at labour courts, filling the vacant posts of labour inspectors, ensuring proper work of remediation coordination cell, and ratifying ILO conventions 29 and 138. The delegation also raised concerns about the reported delays in making labour laws fully compliant with international standards. Among others, the EU delegations stressed the implementation of the UN anti-corruption convention to be eligible for GSP+.

It may be mentioned here that although the UK's DCTS removed the requirement of complying with international conventions, it reserves the right to suspend a country from the DCTS Enhanced Preferences (similar to GSP+) on the ground of violation of labour and human rights.

### Establishing a domestic carbon market, formulating, and implementing carbon reduction policies should comprise a major policy action.

The international trading environment is rapidly transforming as major global economies introduce carbon taxes on imports. The EU is set to adopt its CBAM to start from 2023 with importers having to secure CBAM certificates for imports of selected commodities from 2027. Following the EU, countries including the UK and the US will likely bring in similar measures. At the initial stage of the EU CBAM Bangladesh is not expected to be affected significantly because of the limited product coverage. However, the coverage of such measures will expand in the future, and it is likely that the EU will also include apparel in the CBAM sectors. Thus, the challenge of any loss of tariff preference due to LDC graduation could be compounded by the enforcement of CBAM measures. The pressure of competitiveness would be further aggravated as Vietnam will start enjoying tariff-free market access to the EU under an FTA around the same time of the expiry of Bangladesh's post-

[25] Major policy reforms in such areas as trade, industrial and investment policies, intellectual property, and environmental protection are now considered most essential for negotiating a trade agreement with any major economy in the world. The EU-Vietnam FTA could be an example for Bangladesh in assessing the reforms that are needed for striking a trade deal with the EU.

graduation transition period. Bangladesh's competitors including China, India, and Vietnam, have either established or are in the process of developing domestic carbon markets. Therefore, these countries might see their carbon taxes in the importing countries waived in part or completely. Therefore, along with the preparation for LDC graduation, due attention must also be given to prepare for border carbon tax measures. Following the suggestions of the 8th Five Year Plan, introducing a green tax could be an appropriate policy initiative that would also help deal with changing circumstances in the EU market. However, Bangladesh should take necessary policy measures to establish a domestic carbon market that will help reduce GHG emissions and improve climate resilience.

### Improving firm-level competitiveness can mitigate the impact of preference erosion and help boost export competitiveness.

Any loss in competitiveness for Bangladeshi firms arising from LDC graduation-related policy (tariff) changes in the EU can, to a large extent, be addressed by improving firm-level competitiveness.

Businesses in Bangladesh stand to gain from industrial upgrades to improve their processes and products. While process upgrading calls for enhancing manufacturing techniques in conjunction with the use of cutting-edge technologies and a skilled workforce, product upgrading entails creating more complex or sophisticated goods. Automation and the deepening of capital-intensive production processes are already taking place in the country's garment industry. There is evidence to suggest that Bangladesh's garment sector has a lower level of capital intensity than that of Cambodia, China, India, or Vietnam.[26] There is thus significant potential for increased labour productivity through industrial upgrade.[27]

### Sustainable production practices by the exporting firms and adopting ESG-related compliances will be essential for export promotion.

Growing awareness of climate change and sustainable development are becoming more important in international trade and in attracting investment. An ever-increasing proportion of Western consumers are now emphasising sustainable consumption. Foreign investors are increasingly responsive to the need to protect the environment, and looking for opportunities to invest in sustainable projects.

Thus, ESG compliance is an important factor that many investors and global supply chain leaders linked to the EU take seriously. As climate campaigns and activities gain more traction, compliance scrutiny will increase further. While Bangladesh's clothing industry is faced with various non-compliance issues, the situation prevailing in non-garment export industries and import-competing sectors is even worse.

Sustainable production practices of the exporting firms and the adoption of ESG-related compliance will be important determinants for export success in the future. Any improvements in these areas will improve competitiveness of exporting firms. This will also help improve compliance with the EU supply-chain due diligence. These are the areas where Bangladesh can also seek adjustment and capacity-building support from the EU.

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[26] Razzaque and Dristy (2018) estimate that, compared with Bangladesh's employing 142 workers in producing garment items worth US$1 million, China and Vietnam each require just 48 workers for the same size of export production. The comparable numbers of workers for India and Cambodia are 59 and 75, respectively.

[27] This, however, will come with fewer employment opportunities. Therefore, labour market interventions will be needed to generate employment in other sectors.

### Diversifying the export basket will be important for boosting exports in the EU.

The several trillion-dollar-EU markets are highly diversified. Other than apparel products, it imports hundreds of billions of dollars' worth of machinery, electrical products and appliances, agricultural products, processed food, footwear, leather and leather goods, pharmaceutical and plastic products, and other items. The discussions above also suggest that the EU offers huge potential for export diversification and promotion of Bangladeshi products. Bangladesh will continue to enjoy duty-free preferences in the EU for at least seven more years. Using this opportunity, diversification of the export basket should be given the utmost priority. After graduation (and the expiration of the subsequent three-year grace period), there will be several products with high tariff margins under GSP+ or Standard GSP (Annex A2). Therefore, Bangladesh should explore expanding exports of those products.

### Bangladesh should attract more investment and try to seek additional EU development assistance to develop domestic capacity.

It is well established that FDI is instrumental in boosting export diversification and export promotion. Employment generation, productivity enhancement, and skill upgrading through information and technology transfer and better management practices are some of the direct beneficial effects of FDI. Local businesses may also benefit from the spill-over effects of FDI, which will enable them to upgrade their industries and effectively participate in the global value chain. It is also well known that FDI companies are better placed in obtaining improved export prices.

RMG, energy, engineering products, electric machinery, food processing, and leather and footwear, are some of the promising sectors for attracting EU investments. A big domestic market, a large pool of workforce with very competitive wages, and the existence of a global export industry such as the clothing sector, should make Bangladesh an important investment destination for EU investors, provided that factors affecting investment climate and cost of doing business can be dealt with effectively. EU investors are relocating from China to other developing countries. This can be an opportune moment for Bangladesh to mobilize and take advantage of some of the relocated investments. Bangladesh should consider and engage with the EU for establishing a BIT for attracting more EU investment. Such an agreement should facilitate the discussion for undertaking a full-fledged FTA between the EU and Bangladesh.

The EU is also one of the major donors of development assistance. There are opportunities for seeking more EU assistance for adjusting to changing circumstances and expanding domestic productive capacities.

### Addressing the high cost of doing business, as well as enhancing connectivity and trade facilitation, is critical for enhancing competitiveness.

The cost of doing business is considered excessively high in Bangladesh because of such factors as infrastructural bottlenecks, inefficient customs processes, incompetent port management and trade facilitation measures, dysfunctional inland transportation, and weak governance. Tackling the high cost of doing business and investing in connectivity and trade facilitation measures will be important to boost competitiveness. Improvements in these areas can help recoup a significant portion of any lost trade preference.

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# VI. Annex

**Table A1: State of 32 pre-specified international conventions to qualify for GSP+**

| SL no | International convention to qualify for GSP+ | Accession | Ratification |
|---|---|---|---|
| 1 | Convention on the Prevention and Punishment of the Crime of Genocide (1948) | 5-Oct-98 | |
| 2 | International Convention on the Elimination of All Forms of Racial Discrimination (1965) | 11-Jun-79 | |
| 3 | International Covenant on Civil and Political Rights (1966) | 6-Sep-00 | |
| 4 | International Covenant on Economic Social and Cultural Rights (1966) | 5-Oct-98 | |
| 5 | Convention on the Elimination of All Forms of Discrimination Against Women (1979) | 6-Nov-84 | |
| 6 | Convention Against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment (1984) | 5-Oct-98 | |
| 7 | Convention on the Rights of the Child (1989) | | 3-Aug-90 |
| 8 | Optional Protocol to the Convention on the Rights of the Child on the Involvement of Children in Armed Conflict (2000) | | 6-Sep-00 |
| 9 | Convention on the Rights of Persons with Disabilities (2007) | | 30-Nov-07 |
| 10 | Convention concerning Forced or Compulsory Labour, No 29 (1930) | | 22-Jun-72 |
| 11 | Convention concerning Freedom of Association and Protection of the Right to Organise, No 87 (1948) | | 22-Jun-72 |
| 12 | Convention on Labour Inspection No 81 (1947) | | 22-Jun-72 |
| 13 | Convention concerning the Application of the Principles of the Right to Organise and to Bargain Collectively, No 98 (1949) | | 22-Jun-72 |
| 14 | Convention concerning Equal Remuneration of Men and Women Workers for Work of Equal Value, No 100 (1951) | | 28/01/1998 |
| 15 | Convention concerning the Abolition of Forced Labour, No 105 (1957) | | 22-Jun-72 |
| 16 | Convention concerning Discrimination in Respect of Employment and Occupation, No 111 (1958) | | 22-Jun-72 |
| 17 | Convention concerning Minimum Age for Admission to Employment, No 138 (1973) | | 22-Mar-2022 |
| 18 | Convention on Tripartite Consultations No 144 (1976) | | 17-Apr-1979 |
| 19 | Convention concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour, No 182 (1999) | | 12-Mar-2001 |
| 20 | Convention on International Trade in Endangered Species of Wild Fauna and Flora (1973) | | 20-Nov-1981 |
| 21 | Montreal Protocol on Substances that Deplete the Ozone Layer (1987) | 2-Aug-90 | |
| 22 | Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal (1989) | 1 Apr 1993 | |
| 23 | Convention on Biological Diversity (1992) | | 3 May 1994 |

| SL no | International convention to qualify for GSP+ | Accession | Ratification |
|---|---|---|---|
| 24 | The United Nations Framework Convention on Climate Change (1992) | | 15-Apr-94 |
| 25 | Cartagena Protocol on Biosafety (2000) | | 5-Feb-04 |
| 26 | Stockholm Convention on Persistent Organic Pollutants (2001) | | 12-Mar-07 |
| 27 | The Paris Agreement on Climate Change (2015) | | 21-Sep-16 |
| 28 | United Nations Single Convention on Narcotic Drugs (1961) | 25-Apr-75 | |
| 29 | United Nations Convention on Psychotropic Substances (1971) | 11-Oct-90 | |
| 30 | United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988) | | 11-Oct-90 |
| 31 | United Nations Convention against Corruption (2004) | 27-Feb-07 | |
| 32 | United Nations Convention against Transnational Organised Crime (2000) | 13-Jul-11 | |

Source: Authors' compilations.

**Table A2: Average tariff rates in the EU under different schemes**

| HS code | MFN | GSP | GSP+ | EBA | HS code | MFN | GSP | GSP+ | EBA | HS code | MFN | GSP | GSP+ | EBA |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | 1.1 | 0.6 | 0 | 0 | 33 | 2.8 | 0 | 0 | 0 | 65 | 2.8 | 0 | 0 | 0 |
| 2 | 9.6 | 6.7 | 6.3 | 0 | 34 | 2.1 | 0 | 0 | 0 | 66 | 4.3 | 1 | 0 | 0 |
| 3 | 10.8 | 6.1 | 0.1 | 0 | 35 | 5.7 | 2.3 | 1.8 | 0 | 67 | 2.8 | 0 | 0 | 0 |
| 4 | 6.5 | 0.8 | 0 | 0 | 36 | 6.5 | 0 | 0 | 0 | 68 | 1.2 | 0 | 0 | 0 |
| 5 | 0.3 | 0.1 | 0 | 0 | 37 | 5.2 | 0 | 0 | 0 | 69 | 4.8 | 1.7 | 0 | 0 |
| 6 | 6.4 | 3.1 | 0 | 0 | 38 | 5.3 | 0 | 0 | 0 | 70 | 5.2 | 2.1 | 0 | 0 |
| 7 | 8.8 | 5.5 | 0.6 | 0 | 39 | 6.1 | 1 | 0 | 0 | 71 | 0.6 | 0 | 0 | 0 |
| 8 | 7.9 | 5.3 | 0.3 | 0 | 40 | 2.7 | 0.2 | 0 | 0 | 72 | 0.2 | 0 | 0 | 0 |
| 9 | 2.8 | 1 | 0 | 0 | 41 | 3 | 1.4 | 0.4 | 0 | 73 | 1.7 | 0 | 0 | 0 |
| 10 | 0.6 | 0.1 | 0.1 | 0 | 42 | 5 | 1.2 | 0 | 0 | 74 | 3.4 | 0.7 | 0 | 0 |
| 11 | 10.3 | 0.6 | 0 | 0 | 43 | 1.3 | 0 | 0 | 0 | 75 | 0.7 | 0 | 0 | 0 |
| 12 | 1.1 | 0.4 | 0.3 | 0 | 44 | 2.2 | 0.8 | 0 | 0 | 76 | 6.5 | 3.3 | 0.3 | 0 |
| 13 | 2.2 | 1 | 0 | 0 | 45 | 3.7 | 0.1 | 0 | 0 | 78 | 2.2 | 0.8 | 0 | 0 |
| 14 | 0 | 0 | 0 | 0 | 46 | 2.6 | 0.1 | 0 | 0 | 79 | 3.1 | 1.8 | 1.3 | 0 |
| 15 | 7.1 | 3.6 | 0 | 0 | 47 | 0 | 0 | 0 | 0 | 80 | 0 | 0 | 0 | 0 |
| 16 | 18.3 | 10.2 | 0 | 0 | 48 | 0 | 0 | 0 | 0 | 81 | 3.8 | 1.7 | 0.8 | 0 |
| 17 | 9.1 | 2.2 | 0.2 | 0 | 49 | 0 | 0 | 0 | 0 | 82 | 3.1 | 0.3 | 0 | 0 |
| 18 | 8 | 4.5 | 0 | 0 | 50 | 5.3 | 4.2 | 0 | 0 | 83 | 2.5 | 0 | 0 | 0 |
| 19 | 7.8 | 4.2 | 0 | 0 | 51 | 3.7 | 3 | 0.2 | 0 | 84 | 1.9 | 0 | 0 | 0 |
| 20 | 17.2 | 12.8 | 0 | 0 | 52 | 6.7 | 5.3 | 0 | 0 | 85 | 3 | 0.7 | 0 | 0 |
| 21 | 8.2 | 4.3 | 0.4 | 0 | 53 | 3.7 | 2.9 | 0 | 0 | 86 | 1.8 | 0 | 0 | 0 |
| 22 | 1.7 | 0.5 | 0 | 0 | 54 | 6 | 4.8 | 0 | 0 | 87 | 6.2 | 2.5 | 0 | 0 |
| 23 | 1.5 | 0.3 | 0 | 0 | 55 | 6.5 | 5.2 | 0 | 0 | 88 | 3.6 | 0 | 0 | 0 |
| 24 | 29.4 | 20.7 | 0 | 0 | 56 | 6 | 4.8 | 0 | 0 | 89 | 1.3 | 0 | 0 | 0 |
| 25 | 0.2 | 0 | 0 | 0 | 57 | 7.6 | 6.1 | 0 | 0 | 90 | 2 | 0.1 | 0 | 0 |
| 26 | 0 | 0 | 0 | 0 | 58 | 7.3 | 5.8 | 0 | 0 | 91 | 4.3 | 0.5 | 0 | 0 |
| 27 | 1.5 | 0 | 0 | 0 | 59 | 6.4 | 5.1 | 0 | 0 | 92 | 3.2 | 0 | 0 | 0 |
| 28 | 4.6 | 0.4 | 0.1 | 0 | 60 | 7.9 | 6.3 | 0 | 0 | 93 | 2.8 | 2.8 | 2.8 | 2.5 |
| 29 | 4.4 | 0.9 | 0.1 | 0 | 61 | 11.6 | 9.3 | 0 | 0 | 94 | 2.4 | 0.2 | 0 | 0 |
| 30 | 0 | 0 | 0 | 0 | 62 | 11.6 | 9.2 | 0 | 0 | 95 | 2.2 | 0.1 | 0 | 0 |
| 31 | 4.5 | 2.3 | 0 | 0 | 63 | 10 | 8 | 0 | 0 | 96 | 3.2 | 0 | 0 | 0 |
| 32 | 5.5 | 0.9 | 0.2 | 0 | 64 | 9.9 | 6 | 0 | 0 | 97 | 0 | 0 | 0 | 0 |

Source: Razzaque (2022).

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