LDC Graduation and Economic Partnership with the EU

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The European Union (EU) is an indispensable trade and development partner of Bangladesh. Almost half of Bangladesh's merchandise exports are destined for the EU.

Taking advantage of the Everything But Arms (EBA) initiative -- a trade preference scheme granting duty-free market access for the goods originating from the least developed countries (LDCs) -- Bangladesh's combined exports to the EU and UK expanded rapidly from US$2.5 billion in 2000-01 to $28 billion in 2021-22.

In value terms, more than 80 per cent of all trade preferences for Bangladesh is obtained from European markets. Bangladesh has been the single largest beneficiary of the EU Generalised Systems of Preference (GSP) scheme.

Along with trade, the EU has been one of the most important sources of overseas development assistance (ODA). Over the past five years, the cumulative ODA from EU institutions and individual member countries amount to $2.3 billion, which is around 10 per cent of all ODA received by Bangladesh during the same period.

Between 2017 and 2021, the net FDI flow into Bangladesh from EU countries was $3.5 billion, accounting for about a quarter of all such flows into the country during the same period. The FDI stock in Bangladesh due to the EU is estimated to be more than 12 per cent of the total such stock.

The $6.3 trillion EU import market offers vast export potential for a country like Bangladesh. Even under the current conditions, utilising a methodology proposed by the International Trade Centre, it is estimated that currently only 60 per cent of Bangladesh's export potential is utilised.

The EU's annual apparel import is $180 billion, which is more than 40 per cent of the global market in the same product. Bangladesh has seen its share in extra-EU apparel import rising from just 5 per cent in the late 2000s to about 20 per cent in 2021, capturing much of China's falling share from more than 40 per cent to just above 30 per cent during the same. Therefore, tens of billions of dollars of export potential continue to exist as the overall EU clothing import increases along with China's declining share.

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 as outlined below.

Bangladesh's LDC graduation: Bangladesh's graduation from the group of LDCs in 2026 will result in the cessation of LDC-related trade preferences in most countries such as Canada, China, India, and Japan. The EU (and the UK) would provide an additional three-year transition period and thus EBA trade preferences will come to an end in 2029. After graduation, a country can apply for preferential market access under the EU GSP+ programme, which provides tariff-free entry of goods in 66 per cent EU tariff lines including textile and clothing items.

However, to qualify for GSP+ preference, two criteria will have to be fulfilled. 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 European Union during the past three consecutive years. 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.

Bangladesh meets the vulnerability criterion. Inclusion in GSP+ thus will depend on ratification and effective implementation of the pre-specified international conventions. Bangladesh has already ratified 20 of those conventions and has acceded to the rest While effective implementation can always be subjective, Bangladesh will surely aim to comply with the ratification process.

However, even if Bangladesh is included in GSP+, apparel exports will likely be subject to EU safeguard measures. 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 when the share of those products exceeds certain pre-specified thresholds.

Without delving into technical details, as things stand, if the proposed GSP rules are not amended, Bangladesh would be in a unique situation to qualify for GSP+, yet its clothing items will be ineligible for any preference and end up paying MFN duties. Under this circumstance, clothing items comprising more than 90 per cent of Bangladesh's exports to the EU, will face around 12 per cent tariff against the current zero duty facilities under EBA.

Other countries' trade agreements with the EU: The EU's free trade agreements (FTAs) with other countries could allow competitors to gain competitive advantages vis-à-vis Bangladesh. For instance, because of the EU-Vietnam FTA 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 coming to an end and being replaced with an average tariff of about12 per cent Even countries like Pakistan and Sri Lanka have access to GSP+, while Indonesia, and India, which are other major apparel-supplying countries are currently negotiating FTAs with the EU.

The EU Green Deal and its carbon border adjustment mechanism (CBAM): The recently proposed EU Green Deal aims to make use of a carbon border adjustment mechanism (CBAM) to internalise the cost of CO2 in both domestically produced and imported goods. Under the CBAM, 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 emission trading System (ETS). The CBAM, to be enforced within the next few years, will initially consider six high-energy intensity sectors, viz., cement and glass, steel, aluminium, paper, petroleum and coal products, and chemicals and fertilizers. Additional sectors are likely to be brought under coverage later. This implies that countries' abilities to deal with carbon emissions could be an important 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 sector is already under scrutiny, such standards for other sectors are also equally important and could determine future market access to 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.

The above factors call for immediate policy attention to assess the major trends and emerging issues affecting future 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, while other emerging issues affecting external competitiveness receive inadequate attention.

Given its size and current significance, there is no substitute for the EU market, and thus Bangladesh must prepare to deal with any adverse consequences arising from any factors mentioned above.

There is now a need for developing a medium to long-term strategy and action plan for strengthened Bangladesh-EU cooperation after LDC graduation.

LDC graduation does not mean the end of trade preference. Therefore, Bangladesh must effectively engage with the EU for securing favourable market access terms in the post-LDC graduation period. It is worth pointing out that the EU under EBA initially offered only a double-stage transformation-based rule of origin provisions as preconditions for duty-free market access. Later on, it was derogated to a single-stage transformation from which Bangladesh's woven garments benefited profoundly. In the context of GSP+, therefore, favourable opportunities through proactive engagements must be explored.

The need for securing a trade deal (e.g., FTA) with the EU is often highlighted by many. It is often argued that other trade partners will find Bangladesh an attractive trade partner given its sustained economic growth, making it one of the largest 30 major economies in purchasing power parity terms. However, Bangladesh lacks a credible track record for undertaking and sustaining major policy reforms in such areas as trade, industrial policy, investment, intellectual property and environmental protection that are now considered most essential for negotiating a trade agreement with any major economy in the world. In this context, learning from Vietnam, which has successfully negotiated trade deals with major global trading partners and country groups, can help prepare.

Given the EU's strong focus, giving utmost attention to ESG (environmental, social and governance) factors, including compliance with labour issues, will be critical for a transformed and revitalised trade and economic partnership with the EU.

There are still several years left (until close to the end of 2029) before LDC-related preferences are gone. This provides an opportunity for developing time-bound actions for ensuring conformity with international conventions/standards and to make further improvements in ESG compliance. In many instances, EU technical and financial assistance can be sought for making the desired improvements.

In fine, the Bangladesh-EU relationship is now at a critical juncture. Bangladesh's graduation success will be tested by its export performance in the EU. It is in this context that Bangladesh's embarking on a transformed bilateral partnership with the EU cannot be overemphasised.

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