Policy Brief

The EU-Vietnam Free Trade Agreement: Implications for Bangladesh's Export Competitiveness

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The EU-Vietnam Free Trade Agreement: Implications for Bangladesh's Export Competitiveness

Mohammad Abdur Razzaque, Jillur Rahman, Syful Islam[*]

Abstract

This policy brief assesses the implications of the EU-Vietnam Free Trade Agreement (EVFTA) for the export competitiveness of Bangladesh as it prepares to graduate from Least Developed Country (LDC) status. Through trade and tariff data analysis and modelling exercises, it examines the dual challenges of Vietnam's enhanced market access under the EVFTA and the loss of Bangladesh's preferential treatment in the EU market. The findings highlight significant trade diversion risks, with Bangladesh's apparel and leather exports expected to face severe competitiveness pressures due to post-graduation tariff hikes and Vietnam's enhanced market access.

The paper emphasises the importance of strategic reforms, including improving firm-level competitiveness, diversifying the export basket, aligning with EU sustainability regulations, and addressing infrastructural and logistical challenges. It also underscores the need for proactive engagement with the EU to secure favourable trade terms, such as GSP+ eligibility, while preparing for a potential free trade or comprehensive economic partnership agreement. These measures are crucial for safeguarding Bangladesh's export competitiveness and adapting to a shifting global trade.

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I. Background

The EU, which absorbs almost half of merchandise exports from Bangladesh, is a critical market where sustaining competitiveness remains a top priority.[1] Trade policies and agreements between the EU and other nations warrant close attention, particularly for the readymade garment (RMG) sector, which accounts for over 80 per cent of total export earnings. In this context, the European Union–Vietnam Free Trade Agreement (EVFTA), effective since 2020, has provided Vietnam with significant trade advantages that could have far-reaching implications for its competitors.[2]

The comprehensive EVFTA deal eliminates nearly all tariffs on goods traded between the two partners, enhancing Vietnam's export competitiveness, particularly in sectors such as apparel where Bangladesh has been a major supplier. By securing zero-duty access to the EU market, Vietnam transitions from its earlier Generalised Scheme of Preferences (GSP) tariffs to a more advantageous trade regime. The EVFTA also provides Vietnam with a competitive edge through provisions that go beyond tariff reductions. It addresses non-tariff barriers by fostering greater transparency and regulatory cooperation, particularly regarding technical barriers to trade and sanitary and phytosanitary standards to facilitate smoother market access for Vietnamese exports to the EU, reducing compliance costs. Furthermore, the agreement opens up markets for services and investment, allowing EU businesses greater access to Vietnam's growing service sectors, such as finance, telecommunications, and transport. These provisions attract investments and strengthen Vietnam's trade position by enhancing its industrial and service capacities. In addition, commitments under the EVFTA to uphold international standards on labour rights and environmental protection align Vietnam with the EU's emphasis on sustainable development, further bolstering its appeal as a trading and investment partner.

As against EVFTA developments, Bangladesh seems to be confronted with a challenging landscape. As its RMG exports currently benefit from duty-free access under the Everything but Arms (EBA) scheme, the withdrawal of this preferential arrangement following its LDC graduation will subject its exports to higher tariffs.[3] This scenario sets the stage for "dual trade preference erosion": Vietnam's enhanced access to the EU market under the EVFTA and Bangladesh's tariff escalation post-graduation. Together, these shifting landscapes could significantly undermine Bangladesh's export competitiveness in its most important export market. Understanding these shifts is crucial to formulating strategies to mitigate any potential consequences.

This policy brief aims to examine the evolving export dynamics of Bangladesh and Vietnam in the EU market, focusing on export trends, tariff profiles, and the likely implications of the EVFTA. By analysing these factors, the brief seeks to provide insights and inputs for

[1] When the UK is added to EU countries, this share rises to 58.4 per cent.
[2] The UK also has an FTA with Vietnam, effective January 2021. For the purpose of this paper, we have considered only the EU, excluding the UK.
[3] As per the current EU provisions, Bangladesh can continue to receive EBA duty-free access for its garment exports until the three years after its graduation from LDC status.

policymakers and stakeholders in Bangladesh navigating the emerging complex trade environment.

II. A comparative analysis of export performance and tariff profiles of Bangladesh and Vietnam in the EU market

Export performance and composition

Until 2006, Bangladesh and Vietnam maintained comparable export volumes to the EU. However, since then, and particularly following the recovery from the 2008 Global Financial Crisis, Vietnam's exports have grown at a much faster pace, outpacing Bangladesh's performance despite the latter's otherwise commendable growth. By 2023, Vietnam's exports to the EU reached $50.7 billion, significantly overshadowing Bangladesh's $20 billion (Figure 1). It is worth noting that, while Vietnam's total merchandise exports to the EU are more than double those of Bangladesh, the latter remains dominant in apparel exports, with volumes nearly five times larger than Vietnam's (Figure 2). This strength is largely attributable to the EU's unilateral trade preferences under the Everything but Arms (EBA) scheme, coupled with much less stringent Rules of Origin (RoO) requirements.

Bangladesh is the second-largest source of apparel imports for the EU, accounting for 21.7 per cent of the bloc's apparel imports from non-EU countries. As China shifts away from low-value-added apparel production, its market share in the EU and US has been steadily declining. In the EU, China's share of extra-EU apparel imports dropped sharply by 16 percentage points, from 42 per cent in 2010 to 26 per cent in 2023 (Figure 3). Similarly, in the US, China's share fell from 40 per cent to 21 per cent during the same period (Figure 4). In the EU, Bangladesh absorbed the largest share of China's decline, whereas in the US, Vietnam emerged as the primary beneficiary of China's reduced market presence (Figures 3 & 4).

Between 2010 and 2023, Bangladesh's share of the EU apparel market, measured as a percentage of EU apparel imports from non-EU countries, increased substantially from approximately 6 per cent to 22 per cent, while its share of US apparel imports grew at a much-subdued pace from 3.3 per cent to 9 per cent over the same period. In contrast, Vietnam's share of the EU apparel market rose modestly, from 2 per cent to 4.7 per cent, while its share in the US market surged from less than 1 per cent to nearly 18 per cent. These contrasting trends highlight the advantage Bangladesh enjoyed in the EU market through duty-free access under the Everything but Arms (EBA) scheme, compared to Vietnam, which operated under Standard GSP preferences and faced an average apparel tariff of 9.6 per cent. Bangladesh has long enjoyed duty-free market access in the EU accompanied by relaxed rules of origin conditionalities, allowing a single-stage transformation of apparel products. On the other hand, in the USA, major rivals such as Bangladesh, China, India, and Vietnam do not have any preferential market access, meaning that both Bangladesh and Vietnam face the same tariff rates in that market. Facing the same competitiveness, Vietnam could significantly capture the US apparel market, whereas Bangladesh could not. Therefore, if Bangladesh and Vietnam were to face similar tariff structures in the EU under the EVFTA, Bangladesh's competitive edge could be significantly challenged, potentially leading to a loss of market share to Vietnam.

Figure 1: Total exports of Bangladesh and Vietnam in the EU (billion $)

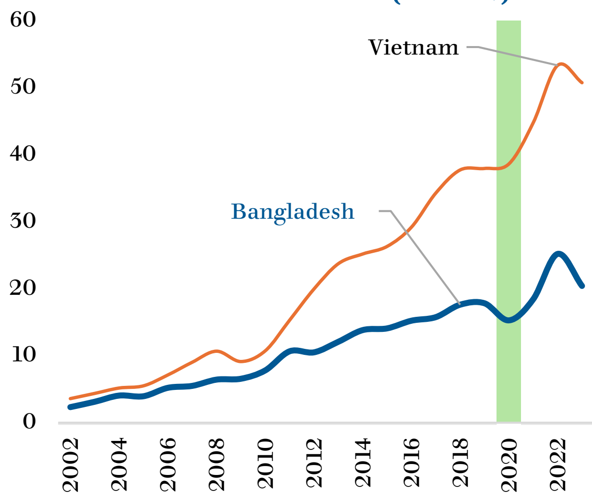


Figure 2: Apparel exports of Bangladesh and Vietnam in the EU (billion $)

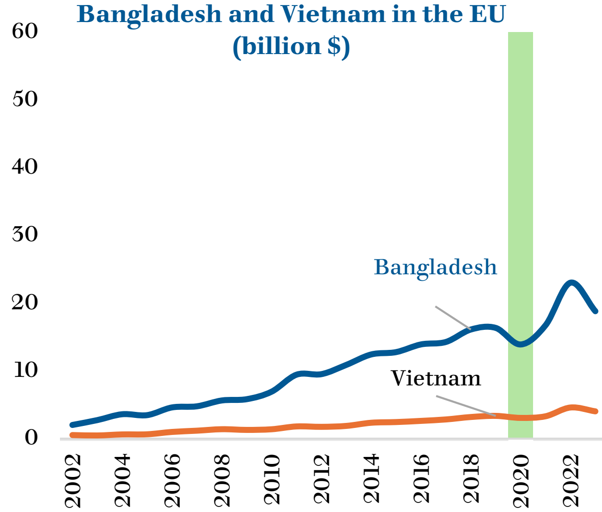


Figure 3: Major suppliers' share in the EU apparel imports (% of total apparel imports from non-EU countries)

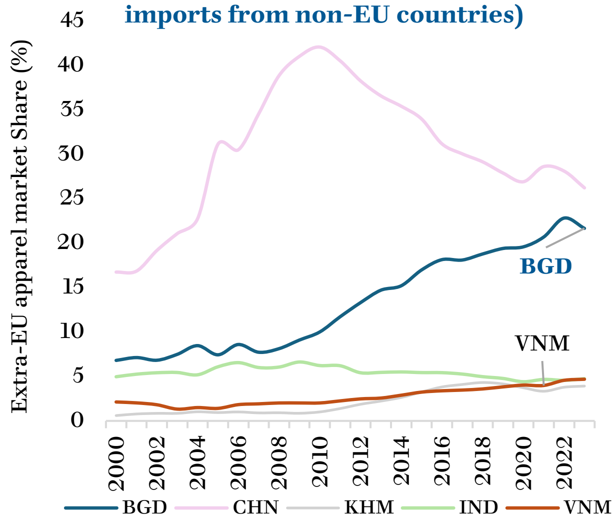
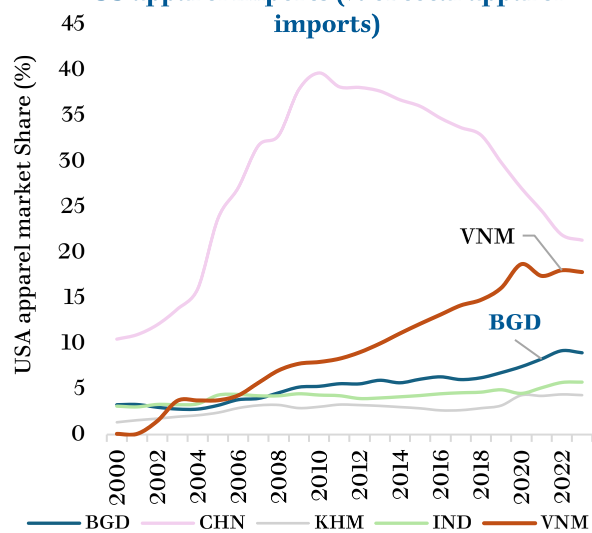


Figure 4: Major suppliers' share in the US apparel imports (% of total apparel imports)



Source: Authors' presentation using the data from EU Comext and USITC.
Notes: CHN = China, VNM = Vietnam, BGD = Bangladesh, IND = India, KHM = Cambodia

Vietnam's exports to the EU market are notably diversified, with machinery and equipment (HS 85) accounting for over one-third of its total exports. In contrast, Bangladesh's exports to the EU are heavily concentrated in apparel, which constitutes more than 90 per cent of its total exports to this market, compared to less than 10 per cent for Vietnam (Figures 5 and 6). Even within the apparel sector, the composition of exports differs significantly between the two countries. Bangladesh's exports are predominantly focused on cotton-based apparel items, which account for 69.1 per cent of its apparel exports, whereas Vietnam's exports are largely concentrated on non-cotton-based apparel items, making up 75.3 per cent of its total in this category.

Figure 5: Bangladesh's apparel export composition in the EU, 2023

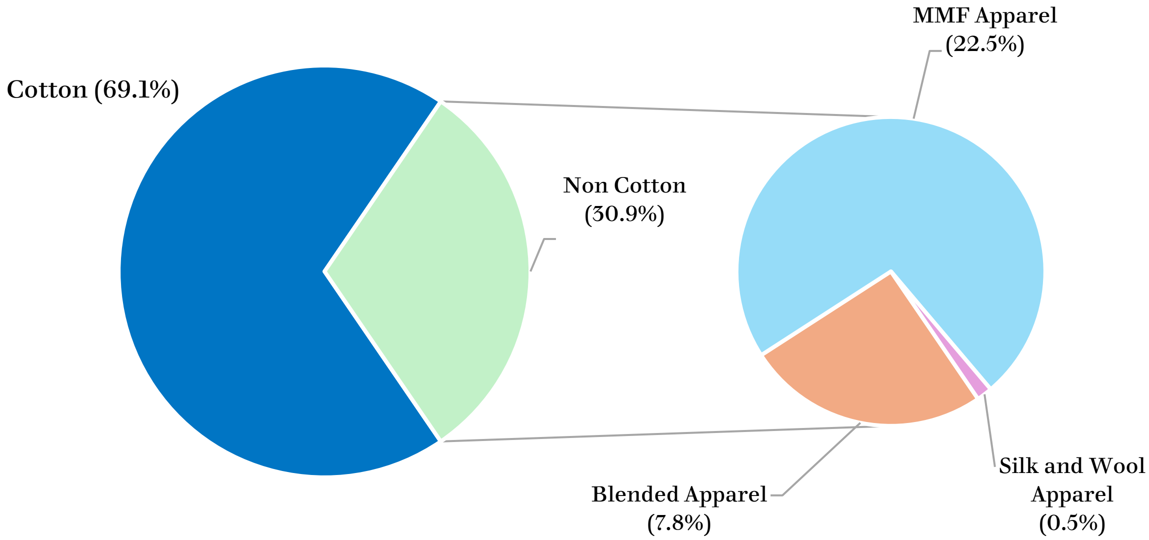
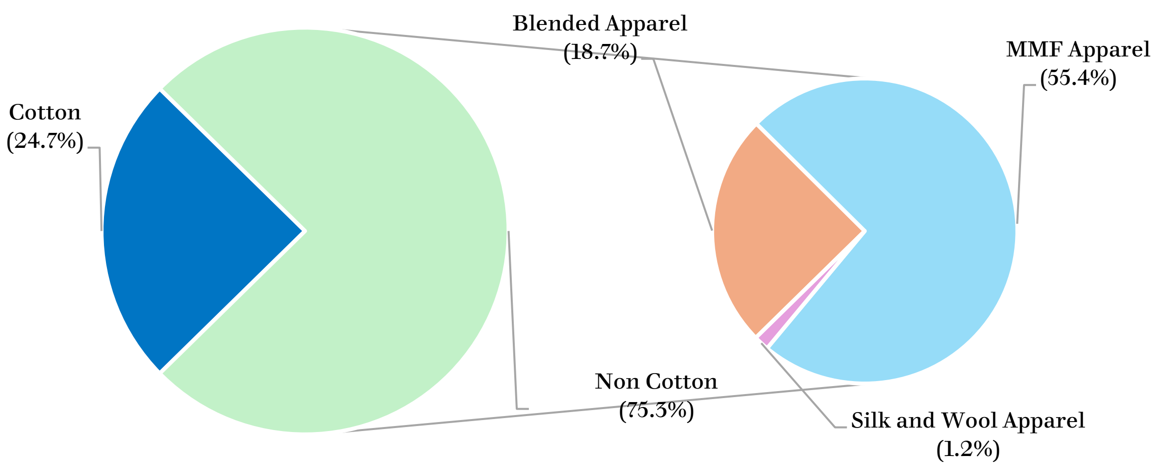


Figure 6: Vietnam's apparel export composition in the EU, 2023



Source: Authors' presentation using EU Comext data.

Bangladesh's top 15 apparel exports to the EU, at the CN 8-digit level, are entirely cotton-based and collectively account for one-third of the EU's total extra-EU imports of these products. In contrast, Vietnam's share of these items is only 3.1 per cent. This suggests that Bangladesh faces limited direct competition from Vietnam in the EU market for its primary cotton-based apparel exports. However, the dynamic shifts when considering man-made fibre (MMF) apparel. Vietnam's top 10 MMF apparel exports hold a 10.6 per cent share of the extra-EU market, compared to Bangladesh's 13 per cent share for the same products. This indicates that both countries hold comparable positions in the EU market for MMF apparel, creating a competitive overlap. As tariffs on Vietnamese apparel are fully eliminated under the EVFTA, Bangladesh is likely to face intensified competition in the EU market, particularly for its MMF apparel exports.

III. Tariff analysis under the EU-Vietnam FTA and Bangladesh's LDC graduation

Upon the entry into force of the EVFTA in 2020, the EU eliminated duties on 71 per cent of tariff lines for Vietnamese exports, with the remaining tariffs set to reach zero over a period of seven years. For textiles and apparel, tariffs on sensitive items are being phased out within five to seven years, while duties on less sensitive items were eliminated within the first three years or immediately upon the agreement's activation. Similarly, for footwear, tariffs on sensitive products are being removed over seven years, while less sensitive categories benefited from immediate or early elimination.

Tariff preference gained by Vietnam under the EVFTA

Before the EVFTA, Vietnam's exports to the EU already benefited from the Standard GSP preferential scheme, but the agreement has introduced varying levels of additional gains across product categories:

- For Vietnam's largest export categories, such as electrical machinery and equipment (HS 85) and machinery (HS 84), weighted tariff rates under the Standard GSP were already near zero. Consequently, the EVFTA provides minimal incremental benefits for these items.
- In contrast, significant gains arise for key export sectors like knitwear (HS 61), woven apparel (HS 62), and footwear (HS 64), where pre-EVFTA weighted tariffs under Standard GSP were 9.4 per cent, 9 per cent, and 8.9 per cent, respectively. With the gradual elimination of these tariffs under the EVFTA, Vietnam stands to enhance its price competitiveness substantially in these categories as the agreement is fully implemented.

Bangladesh's post-graduation tariff scenarios

Bangladesh, on the other hand, currently enjoys duty-free access to the EU under the Everything but Arms (EBA) initiative for least-developed countries. However, following LDC graduation and a three-year transition period, Bangladesh will lose this preferential treatment. [4] Its future tariff regime will depend on qualifying for either the GSP+ or Standard GSP schemes, contingent on meeting specific eligibility criteria.[5]

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[4] The EU allows a three-year extension of EBA duty-free access for graduating LDCs for their smooth transition.

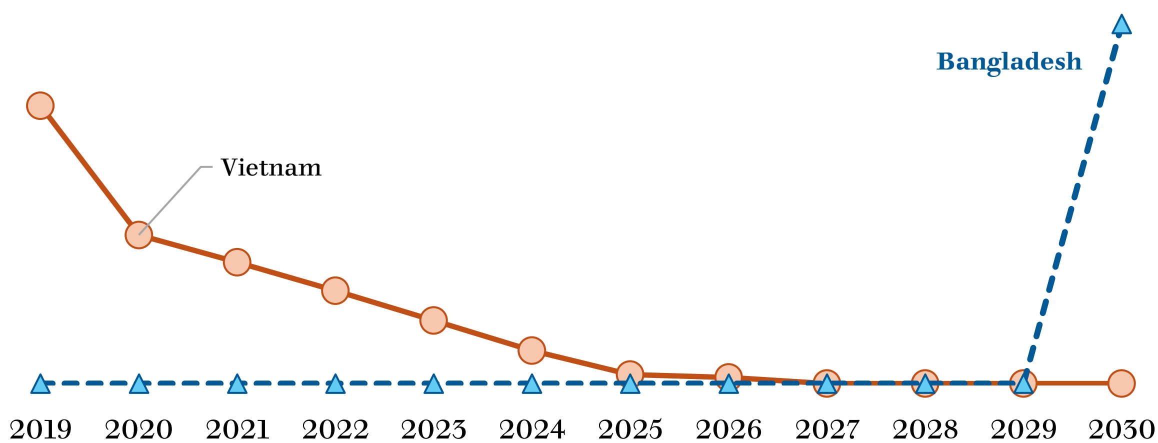
[5] GSP+ is the second-best preferential tier after Everything But Arms (EBA), which provides duty-free access for 66 per cent of EU tariff lines. On the other hand, Standard GSP provides tariff concessions for certain products for developing countries. To be eligible for GSP+ preference, Bangladesh must meet two criteria: vulnerability criteria and sustainable development criteria. The vulnerability criterion requires the eligible country to have a non-diversified economy, where the country's seven largest sections of GSP-covered imports account for more than 75 per cent of its total GSP-covered imports to the European Union over the past three consecutive years. On the sustainable development criterion, a beneficiary country is required to ratify and effectively implement 32 international agreements and conventions related to human rights, labour rights, environmental protection, climate change, and good governance. Bangladesh

- Even if Bangladesh qualifies for the Standard GSP, its apparel exports will face an average tariff of 9.5 per cent, while leather and processed food will be subject to weighted tariffs of 7 per cent and 5.8 per cent, respectively.
- Under the proposed EU GSP 2024–34, safeguard measures will exclude Bangladesh's clothing exports from any tariff preferences, forcing them to face most-favoured-nation (MFN) duties of around 12 per cent. This is significantly higher than the 9.6 per cent average under Standard GSP and, of course, a steep rise from the current zero tariffs under EBA and GSP+.

Reversal of tariff preferences

The combined effects of the EVFTA and Bangladesh's LDC graduation create a stark contrast in tariff trajectories. Vietnam will see its clothing export tariffs to the EU decline from an average of over 9 per cent to zero by the time Bangladesh transitions to a higher tariff regime, potentially facing MFN duties of around 12 per cent (Figure 7). This reversal of tariff preferences could lead to significant trade diversion, with Vietnam becoming increasingly competitive in the EU market at the expense of Bangladesh. The implications for Bangladesh's export performance could be substantial, given that over 90 per cent of its exports to the EU consist of clothing.

Figure 7: Tariff implication on apparel products for Bangladesh and Vietnam in the EU market (%)



Source: Authors' analysis using EU Comext data.

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has already fulfilled the vulnerability criterion, as the seven largest sections of GSP-covered imports account for more than 75 per cent of its total GSP-covered imports to the EU. To qualify for GSP+, it will be necessary for Bangladesh to ratify and effectively implement all 32 conventions.

According to the proposed EU GSP 2024-34 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 percent of total EU imports of the same products and exceeds the product graduation threshold during a calendar year. Bangladesh's current exports under GSP section S-11b (clothing items) are way above the threshold 6 per cent market share in the EU. 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 to attract any tariff preference. However, Bangladesh's share is almost half of all GSP-covered clothing imports into the EU.

In summary, the phased tariff reductions for Vietnam under the EVFTA, combined with the potential loss of preferential access for Bangladesh, will fundamentally alter the competitive landscape in the EU market. This shift underscores the urgency for Bangladesh to explore strategies to mitigate trade diversion risks and maintain its export competitiveness.

IV. Effect of the EVFTA on Vietnam's exports to the EU market

The immediate impact of EVFTA on Vietnam's exports to the EU is challenging to isolate due to global disruptions, including the COVID-19 pandemic and the economic consequences of the Russia-Ukraine conflict. Despite these challenges, an econometric application of the Synthetic Control Method (SCM) provides valuable insights into the relationship between tariff reductions and export growth.

Vietnam's apparel tariffs in the EU market are being phased out under four reduction schedules: A (immediate elimination), B3 (phased over four years), B5 (phased over six years), and B7 (phased over eight years). Schedule A applies to non-sensitive items, while B7 is reserved for the most sensitive products. Apparel items under B5 account for the largest share of Vietnam's exports to the EU, followed by B7 and B3. By 2023, tariffs for schedules A and B3 were fully eliminated, while tariffs under B5 and B7 remain in the phase-out process, set to end in 2025 and 2027, respectively (Table 1). Between 2020 and 2023, export growth was strongest for tariff-free categories (schedules A and B3), while exports of sensitive items under B7 declined in absolute terms. These trends suggest that Vietnam is strategically expanding its apparel exports in categories where tariffs have been eliminated. By 2027, when all apparel tariffs are phased out, Vietnam is likely to achieve substantial growth in the EU market for its apparel sector.

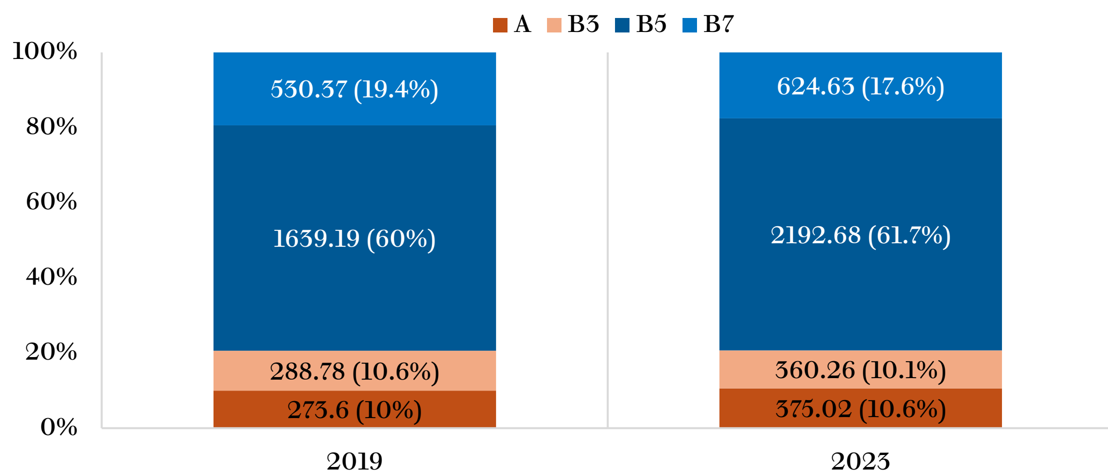
- The Synthetic Control Method allows for estimating the EVFTA effect by creating a counterfactual scenario based on comparable countries without similar trade agreements. Figures 9 and 10 show the actual versus counterfactual exports of Vietnam to the EU. Without the EVFTA, Vietnam's counterfactual total exports to the EU would have been $44.8 billion, compared to actual exports of $50.9 billion, indicating a cumulative increase of 13 per cent during the first four years of the EVFTA. For apparel, the counterfactual value was $3.6 billion, while actual exports reached $4.1 billion, reflecting a cumulative growth of 13.6 per cent in the sector, directly linked to tariff reductions. These findings highlight the positive impact of the EVFTA on Vietnam's export performance, particularly in apparel. As remaining tariffs under schedules B5 and B7 are phased out, Vietnam's competitiveness in the EU market is expected to strengthen further.

Table 1: Vietnam's apparel exports growth by EVFTA tariff schedule, 2020-2023 (%)

EVFTA tariff schedule	MFN tariff (%)	Standard GSP tariff (%)	EVFTA tariff in 2023 (%)	Exports growth during 2020-2023 (%)
A	11.4	9.1	0	11.3
B3	11.7	9.3	0	8.8
B5	11.7	9.4	3.9	4.4
B7	12	9.6	6	-13.8

Source: Authors' calculation using the data from EU Comext.
Notes: Tariff cut under Category A: Immediate, B3: 4 annual stages, B5: 6 annual stages, B7: 8 annual stages

Figure 8: Vietnam's apparel export by EVFTA tariff schedule (%)



Source: Authors' analysis using data from EU Comext and WITS databases.
Notes: Tariff cut under Category A: Immediate, B3: 4 annual stages, B5: 6 annual stages, B7: 8 annual stages

Figure 9: Vietnam's actual and counterfactual exports to the EU ($)

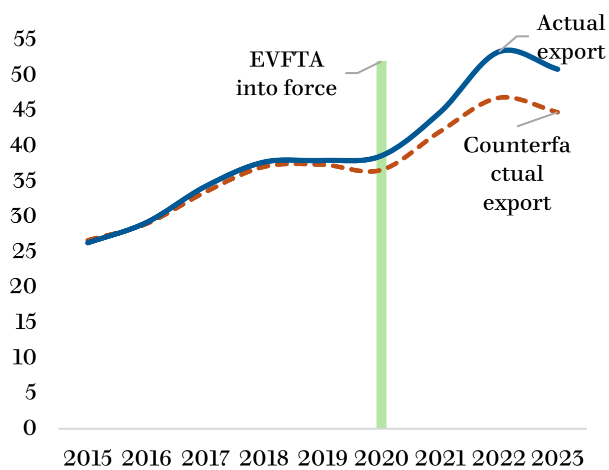
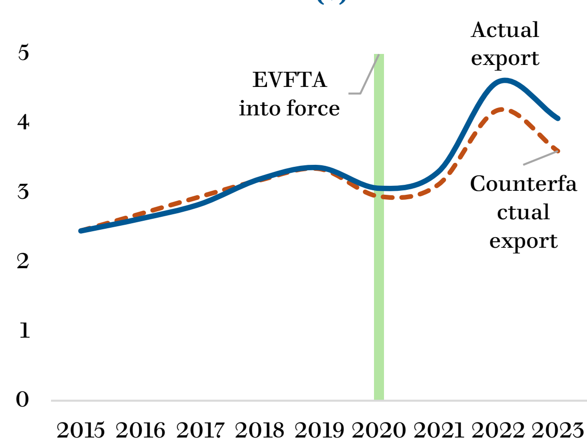


Figure 10: Vietnam's actual and counterfactual apparel exports to the EU ($)



Source: Author's representation using the systemic control method (SCM).

Rules of origin requirement

Although the EVFTA significantly reduces tariffs for Vietnam across nearly all export categories, it imposes strict rules of origin (RoO) that must be met to access preferential rates. The EVFTA RoO are similar to the EU GSP and the EU-Singapore Free Trade Agreement.

- Most agricultural products must be wholly obtained in Vietnam to benefit from tariff reductions. Processed agricultural goods require a change in tariff classification, with non-originating content subject to weight limitations ranging between 20 per cent and 60 per cent.
- For textiles and apparel, a double transformation rule applies, meaning that fabric must be produced from locally sourced fibre, or garments must be made from locally produced yarn to qualify for preferential tariffs. However, the FTA includes some flexibility for mixed fabrics, allowing for limited exemptions under specific conditions.[6]
- For other products, the RoO generally mandates either a change in tariff heading or a restriction on the value of non-originating materials, which must fall between 50 per cent and 70 per cent of the product's total value.

The double transformation requirement for apparel under the EVFTA presents significant challenges for Vietnam due to its reliance on low-cost fabric imports from China. This dependency limits its ability to meet the necessary value-addition criteria. Although Vietnam has made progress in developing its backward linkage capacity—evidenced by a 21.8 per cent increase in woven fabric production in the first quarter of 2024—achieving the required value addition remains a major hurdle. Between 2019 and 2022, Vietnam's gross value addition to total textile output rose by 3.1 percentage points, from 23.5 per cent to 26.6 per cent. This upward trend indicates that while Bangladesh may not face immediate preference erosion due to the EVFTA, competitive pressure could increase in the future as Vietnam continues to enhance its domestic value-added capacity.

As an LDC, Bangladesh benefits from relaxed RoO under the EU's Everything But Arms (EBA) initiative, requiring only 30 per cent domestic value addition for most products and a single-stage transformation for apparel. However, these rules will tighten after LDC graduation. Apparel exports will need to meet a double transformation requirement to qualify for GSP+ or Standard GSP preferences, while the value addition threshold for non-apparel exports will rise from 30 per cent to 50 per cent. If safeguard measures under the proposed EU GSP framework are triggered, Bangladesh's apparel exports will face Most Favoured Nation (MFN) duties and will not need to meet RoO criteria, further complicating its trade competitiveness.

EVFTA and EVIPA: Implications for Foreign Investment in Vietnam

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[6] Printed fabrics will benefit from the 'printing rule', which allows printed fabric as originating if printing is accompanied by at least two preparatory or finishing, subject to the value of the unprinted fabric used does not exceed 47.5 % of the ex-works price of the product.

The EVFTA is complemented by the EU-Vietnam Investment Protection Agreement (EVIPA), which, while not yet enacted, is expected to further bolster Vietnam's economic position. Research indicates that free trade agreements (FTAs), particularly those paired with investment agreements, create a stable and predictable trade environment that reduces uncertainties and encourages long-term investments. By eliminating tariffs and non-tariff barriers, FTAs attract foreign direct investment (FDI) as firms seek to capitalise on improved market access and reduced production costs in member countries.

The EVIPA is designed to enhance investor confidence through legal safeguards, offering protections such as dispute resolution mechanisms, which are vital for attracting and retaining foreign investments. This combination of trade liberalisation and investment protection within the EU-Vietnam agreements is projected to increase FDI inflows into Vietnam by 10–20 per cent, particularly in sectors like manufacturing and services. These investments are anticipated to bring significant spillover effects, enhancing Vietnam's productive capacity, fostering technology transfer, and boosting its global trade competitiveness.

V. Impact of the EVFTA on Bangladesh

To analyse the impact of the EU-VNM FTA on Bangladesh we employed a Computable General Equilibrium model, more specifically, a standard version of the Global Trade Analysis Project (GTAP) model. GTAP is a multi-sector, multi-region model and one of the most popular and widely used tools for analysing trade policy impacts, including free trade agreements.[7]

Simulation design

The EVFTA will eliminate tariffs on Vietnam's exports to the EU by 2027 while addressing non-tariff measures (NTMs) and improving trade facilitation. Key provisions include reducing NTMs, such as technical barriers to trade and complex certification processes, to ease market access for Vietnamese goods. Although these measures, along with tariff elimination, enhance Vietnam's competitiveness, stringent rules of origin (RoO), such as the double-stage transformation requirement for apparel, present challenges that may limit the agreement's full potential. Additionally, the EVFTA and EVIPA are expected to attract significant foreign direct investment (FDI), with spillover effects improving Vietnam's productive capacity and trade competitiveness. Conversely, Bangladesh is expected to face preference erosion in its EU exports following its LDC graduation. To assess these impacts, two simulations were conducted:

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[7] The GTAP 11.0 database used for this analysis, provides global data for 160 regions/countries, 65 sectors, and 7 factors of production, referenced to the year 2017. These sectors cover 45 goods and 20 services. For the purposes of this study, the 65 sectors have been aggregated into 15 product/service categories, the regions into 21, and the factors classified into five groups: land, skilled labour, unskilled labour, capital, and natural resources. To reflect the pre-FTA global scenario, the GTAP database was updated to 2019 using GDP data from the World Development Indicators (WDI) of the World Bank.

Simulation 1: Evaluates the effects of the EVFTA alone.

Simulation 2: Examines the combined effects of the EVFTA and Bangladesh's LDC graduation.

Each simulation considers two scenarios:

- Scenario 1: Benefits of tariff elimination, reductions in NTMs, trade facilitation, and investment promotion for Vietnam.
- Scenario 2: Incorporates the restrictive effects of stringent RoO on Vietnam's exports, alongside the benefits outlined in Scenario 1.

Key Findings

Figures 11, 12 and 13 present the effects of the EVFTA. The findings are summarised below:

- Vietnam's export growth:
    - The EVFTA could increase Vietnam's exports to the EU by 82 per cent from baseline levels if RoO restrictions were absent. However, with RoO requirements, export growth is projected at 47 per cent.[8]
- Impact on Bangladesh's exports:
    - Under Scenario 1, Bangladesh's total exports to the EU are projected to decline by 3 per cent due to trade diversion.
    - In Scenario 2, with RoO constraints on Vietnam, the decline is smaller: 1.8 per cent for total and apparel exports, and 6.5 per cent for leather and leather products.
- Other competitors, such as China and Indonesia, are also expected to experience export losses in apparel and leather goods, with relatively higher reductions than Bangladesh.
- Overall impact on Bangladesh:
    - Total exports are projected to decrease by 0.3 per cent under Scenario 2, with apparel and leather exports declining by 0.6 per cent and 2.1 per cent, respectively.
    - Imports are estimated to fall by 0.5 per cent, with capital goods experiencing the largest reduction.
    - The limited export impact results in a small adverse effect on employment (Figure 12).
    - Bangladesh's GDP is expected to decline by 0.01 per cent, while welfare losses are equivalent to 0.06 per cent of GDP under Scenario 2.

[8] This growth is attributed to trade creation from tariff removal and trade diversion away from competitor countries. These findings align with other impact assessment studies on the EVFTA (European Commission, 2019).

These findings underscore the dual impact of the EVFTA on Vietnam and Bangladesh, highlighting Vietnam's substantial gains despite RoO challenges and Bangladesh's relatively moderate losses, driven by trade diversion and the erosion of export preferences.

Figure 11: Impact of EVFTA on Bangladesh's exports to the EU (% change from the baseline)

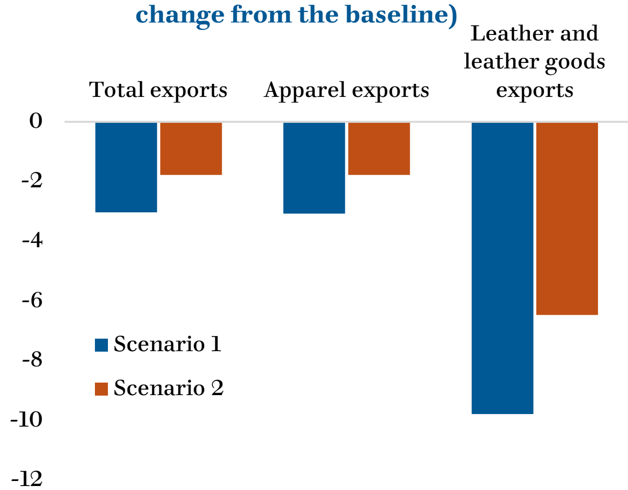


Figure 12: Impact of EVFTA on Bangladesh's GDP, employment, and welfare (% change from the baseline)

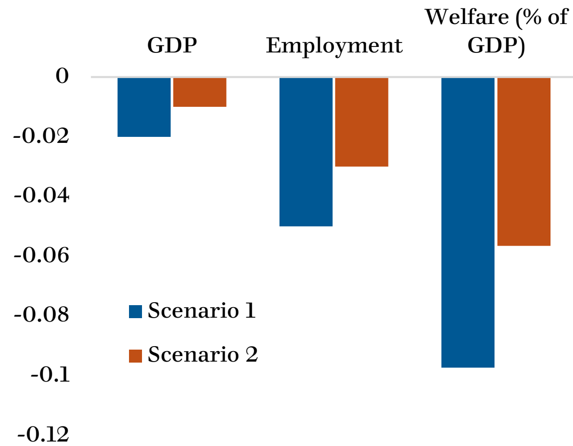
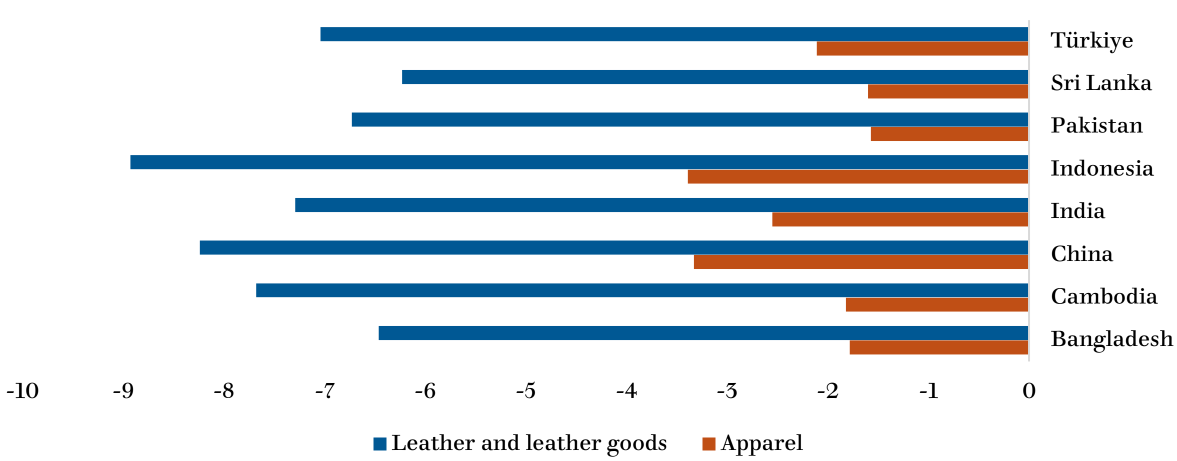


Figure 13: Potential impact of EVFTA on comparator's exports to the EU - apparel and leather goods (% change from the baselind) - in scenario 2



Note: Scenario 1: EVFTA (without the stringent rules of origin that Vietnam is facing under the FTA); Scenario 2: EVFTA (including stringent rules of origin that Vietnam is facing under the FTA).
Source: Authors' estimates based on the GTAP model.

Impact of EVFTA and LDC graduation-related preference erosion of Bangladesh: Key results

Figures 14 and 15 present the combined effects of the EVFTA and the preference erosion resulting from Bangladesh's impending LDC graduation. The findings are summarised below:

- Vietnam's export growth:
  - In Scenario 1 (tariff hikes for Bangladesh, full tariff elimination for Vietnam, trade facilitation, and investment promotion under the EVFTA), Vietnam's exports to the EU are projected to increase by 84 per cent.
  - In Scenario 2, where Vietnam must meet stringent rules of origin (RoO) for duty-free access, its export growth to the EU is estimated at 49 per cent.

- Bangladesh's export impact:
  - Bangladesh's exports to the EU are simulated to decline by 21.2 per cent under Scenario 1.
  - Under Scenario 2, with Vietnam subject to RoO restrictions, the decline in Bangladesh's exports to the EU is slightly smaller at 20.3 per cent.

- Sectoral Impacts on Bangladesh:
  - In Scenario 2, apparel exports to the EU are estimated to fall by nearly 20 per cent.
  - Leather, leather goods, and textiles are projected to decline by one-third, while processed food and light engineering exports are expected to contract by 12–16 per cent.

- Overall Trade Impacts:
  - Total exports are projected to decrease by 4.4 per cent from the baseline under Scenario 2, with declines of 6.5 per cent in apparel, 5.2 per cent in leather and leather goods, and 3.9 per cent in textiles. [9]
  - Total imports are expected to shrink by 5 per cent, with the largest absolute reductions in heavy machinery and textile products, including cotton and fibres/fabrics.

- Macroeconomic and Employment Effects:
  - Bangladesh's GDP is projected to decline by nearly 1 per cent from the baseline under Scenario 2, driven by LDC graduation-related tariff hikes and trade diversion under the EVFTA.
  - Approximately 1.5 per cent of workers, primarily unskilled, could lose employment.
  - Welfare losses are estimated to amount to 1.5 per cent of GDP.

These findings underscore the dual challenges Bangladesh faces from the EVFTA's implementation and its post-LDC graduation tariff regime, highlighting significant impacts on trade, GDP, and employment.

[9] Post-graduation Bangladesh will also lose preference to other markets; thus, the overall impact can be much higher. Given the scope of this study, this paper analyses the impact of eroding competitiveness due to EU-VNM FTA and post-graduation preference erosion in the EU market only.

Figure 14: Impact of EVFTA and LDC graduation on Bangladesh's exports to the EU (% change from the baseline)

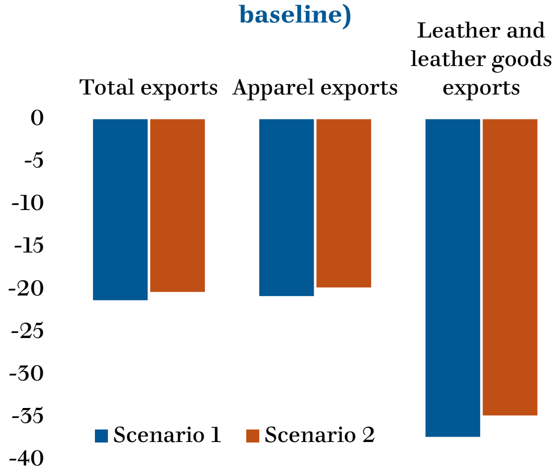
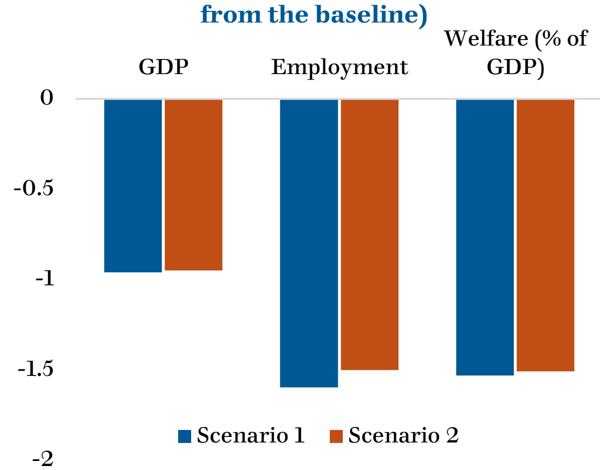


Figure 15: Impact of EVFTA and LDC graduation on Bangladesh's GDP, employment, and welfare (% change from the baseline)



Source: Authors' estimates based on the GTAP model.
Note: Scenario 1: EVFTA (without the stringent rules of origin that Vietnam is facing under the FTA and Bangladesh's LDC graduation; Scenario 2: EVFTA (including stringent rules of origin that Vietnam is facing under the FTA) and Bangladesh's LDC graduation

Price effect of EVFTA on Bangladesh's apparel export price in the EU

The tariff elimination under the EVFTA is expected to enhance Vietnam's price competitiveness in the EU market. To estimate the EVFTA's impact on Bangladesh's apparel export prices, a dynamic panel data econometric model was employed. The findings indicate that a 10 per cent reduction in Vietnamese apparel prices leads to only a 0.6–0.7 per cent decrease in Bangladesh's export prices.

This limited effect suggests that even if Vietnam lowers its apparel prices in line with the tariff preferences it gains under the EVFTA, the overall impact on Bangladesh's export prices will remain minimal. The modest price effect is attributed to Vietnam's relatively low market power in the EU apparel market compared to other major competitors. In contrast, the prices of other significant exporters with larger market shares exert a stronger influence on Bangladesh's export prices. Consequently, the direct welfare loss for Bangladesh from Vietnam's tariff-driven price competitiveness under the EVFTA is expected to be minimal.

Caveats in interpreting modelling results

The results from the modelling exercises provide valuable insights into the potential impacts of the EVFTA on Bangladesh. However, these findings should be interpreted with caution, as they are subject to several limitations. Firstly, the model relies on theoretical frameworks and assumptions that may not fully reflect the complexities of global trade and economic dynamics. Additionally, dynamic shifts in trade patterns, supply chain disruptions, and evolving policy measures—such as potential changes to the EU's GSP provisions—could affect the underlying assumptions of the simulations. The results are also dependent on the accuracy of input data, which may not adequately capture sector-specific intricacies or variations in firm-level behaviour. For industries like apparel, where market power and global production networks play a significant role, these aspects are often difficult to represent within empirical modelling frameworks. Therefore, while the modelling results provide a robust foundation for policy discussion, they should be supplemented with qualitative insights and ongoing monitoring of real-world developments.

VI. Policy recommendations

The EU-Vietnam Free Trade Agreement (EVFTA) has introduced significant shifts in the competitive dynamics of the EU market, particularly for apparel exports. With the phased elimination of tariffs and reduced non-tariff barriers, Vietnam's competitiveness in the EU has been strengthened, supported further by its efforts to enhance domestic value addition and attract foreign direct investment. For Bangladesh, the impending LDC graduation and the associated loss of duty-free access under the EU's Everything But Arms (EBA) scheme present critical challenges. Coupled with Vietnam's growing presence in the EU market, these developments underscore the urgency for Bangladesh to adapt its trade and industrial strategies to improve export competitiveness, consider options for seeking extended trade preferences, and address any potential broader economic impacts. In this regard, several recommendations are proposed

Actively engage with the EU to secure favourable post-graduation terms

- Following its graduation and the subsequent three-year transition period, Bangladesh will no longer qualify for EBA benefits and may instead transition to GSP+ or Standard GSP, each have significant tariff implications.To mitigate the adverse shock arising from post-graduation tariff hikes, Bangladesh should seek an extension of the transition period by 3-5 years, in addition to the existing three years allowed under the EU-GSP regime for the graduated LDCs.
- Bangladesh needs to take time-bound actions to comply with the 32 international conventions required for the EU's GSP+ scheme, focusing on effective implementation. It should seek technical and financial assistance from the EU to help build institutional capacity and ensure compliance with GSP+ commitments.
- The EU's extension of the current GSP scheme until 2027 provides Bangladesh with an opportunity to negotiate favourable terms, including the removal of safeguard measures (Article 29) to retain duty-free access for apparel under GSP+ post-LDC graduation, and relaxation of the double-stage transformation rules of origin for apparel and 50% value addition requirement for non-RMG sectors.

Pursuing a Free Trade and Investment Agreement (FTIA) with the EU

Bangladesh should explore the possibility of a full-fledged Free Trade and Investment Agreement (FTIA) or a Comprehensive Economic Partnership Agreement (CEPA) with the EU to secure long-term market access and attract foreign direct investment (FDI). While seeking GSP+ preferences post-LDC graduation is a viable interim solution, this approach is inherently temporary. As Bangladesh aspires to achieve upper-middle-income status, it will no longer qualify for unilateral trade preferences from the EU. Establishing an FTIA or CEPA is therefore critical for maintaining duty-free access to the EU market, particularly for the apparel sector. Additionally, such an agreement with Bangladesh's largest export destination would enhance the country's appeal to FDI. Securing an FTIA with a developed economy like the EU would, however, necessitate undertaking extensive reforms and liberalisation commitments. These may include:

- Labour standards and environmental regulations: Meeting EU expectations by adopting and effectively implementing international labour and environmental standards, which can also enhance the sustainability of exports.
- Trade facilitation and regulatory alignment: Improving customs procedures, addressing non-tariff barriers, and aligning domestic regulations with EU standards to ensure smoother market access.
- Sectoral competitiveness: Upgrading domestic industries to meet stringent rules of origin (RoO) and enhance value addition, particularly in the textiles and apparel sectors.
- Investment and services liberalisation: Opening up select sectors for foreign investment and integrating them into global value chains, fostering productivity and competitiveness.

These reforms, though challenging, would strengthen Bangladesh's economic foundation and global competitiveness while enhancing its appeal for foreign investment. However, negotiating an FTA with the EU would be a complex and lengthy process, requiring extensive preparation, including institutional capacity building, feasibility studies, and stakeholder engagement. The EU's high standards in labour rights, environmental protection, and trade facilitation must be met, alongside potential short-term sectoral adjustments. Despite these challenges, the long-term benefits—sustained market access, enhanced export competitiveness, and increased FDI—make pursuing an FTA a strategic necessity for Bangladesh.

Enhancing firm-level competitiveness to mitigate preference erosion

Improving firm-level competitiveness through industrial upgrading and innovation is critical to mitigating the impacts of tariff changes resulting from Bangladesh's LDC graduation in the EU market. Advancing production processes with modern technologies, skilled labour, and a focus on higher-value products will strengthen business resilience and export competitiveness. In the apparel sector, boosting local production of high-quality fabrics is essential to reducing import dependence and lowering production costs. This can be achieved through targeted policies such as tax incentives, low-interest financing, and cash subsidies for textile and accessory manufacturers. Modernising textile mills with advanced machinery will further ensure globally competitive output. Additionally, fostering ancillary industries like zippers, buttons, and packaging will enhance supply chain efficiency and resilience, contributing to the overall competitiveness of Bangladesh's apparel exports.

Diversifying the export basket to mitigate trade preference erosion

Diversifying exports is critical to reducing the adverse effects of trade preference erosion in the EU market. While apparel dominates Bangladesh's exports, the highly diversified EU market offers significant opportunities in sectors such as machinery, electrical products, agricultural goods, processed food, pharmaceuticals, and plastics, which collectively account for billions of dollars in imports. Post-LDC graduation, tariffs for these products will remain relatively low, and Vietnam's gains under the EVFTA in these categories are minimal. Expanding non-apparel exports can help offset potential trade losses from the EVFTA and LDC graduation. A previous FES-RAPID study identified several promising sectors beyond apparel with growth potential in the EU market. The government should introduce targeted policies to support these industries, including export incentives, capacity-building initiatives, and market access facilitation, to help them thrive in the competitive EU landscape.

Enhancing trade infrastructure and reducing costs to boost competitiveness

Addressing infrastructural constraints, lowering the cost of doing business, and improving trade logistics are essential to facilitating smoother trade operations and reducing export costs. Bangladesh's high cost of doing business is driven by infrastructural bottlenecks, inefficient customs processes, poor port management, weak inland transportation systems, and governance challenges.

To tackle these issues, targeted investments in infrastructure, port modernisation, and customs automation are critical. Adopting advanced logistics technologies can streamline supply chains, reduce lead times, and lower trade costs, enhancing export competitiveness. Public-private partnerships should be leveraged to bridge infrastructure gaps and improve the efficiency of logistics services, ensuring a more competitive trade environment.

Ensuring compliance with EU Sustainability Due Diligence Regulations

To maintain and enhance export competitiveness in the EU market, Bangladesh must align with the European Commission's proposed Directive on Corporate Sustainability Due Diligence. Proactively implementing robust human rights and environmental due diligence frameworks within supply chains is essential. Adopting sustainable production practices and adhering to ESG-related regulations will be critical for long-term success. There is the need for supporting businesses, particularly in high-risk sectors such as textiles, by providing clear guidelines, training programmes, and resources to ensure compliance with EU standards. Additionally, promoting sustainability, enhancing transparency, and fostering collaboration with international partners will help exporters align with EU guidelines. These measures will safeguard market access, strengthen Bangladesh's competitive position, and attract sustainable investments.

Align with the EU's Carbon Border Adjustment Mechanism (CBAM)

Bangladesh must prepare to align with the EU's Carbon Border Adjustment Mechanism (CBAM) to safeguard its export competitiveness in the evolving global trade landscape. Introduced in October 2023, CBAM imposes carbon taxes on imports to account for their embedded emissions. While Bangladesh is not currently affected, the scope of CBAM may expand to include the apparel sector, posing significant challenges alongside the loss of tariff preferences due to LDC graduation and rising competition from countries like Vietnam. Competitors such as China, India, and Vietnam are already making progress by increasing renewable energy use and establishing domestic carbon markets, putting Bangladesh at risk of being disproportionately affected if it fails to act proactively.

To address these challenges, Bangladesh should consider introducing a domestic carbon tax and establishing a carbon market to reduce greenhouse gas emissions and align with CBAM requirements. These measures would also improve climate resilience and enhance the country's position as a responsible trade partner. However, physical constraints, such as limited land for renewable energy infrastructure, make compliance particularly challenging. Bangladesh should therefore advocate for greater flexibility in international frameworks, including CBAM, for countries with similar limitations. Additionally, seeking technical and financial assistance from development partners will be critical to implementing effective carbon reduction strategies and ensuring long-term competitiveness in the EU market.

VII. Conclusion

The EU-Vietnam Free Trade Agreement (EVFTA) marks a significant shift in the EU's trade landscape, granting Vietnam a competitive edge through tariff eliminations, reduced non-tariff barriers, and enhanced market access. For Bangladesh, this development coincides with its impending graduation from LDC status, which will phase out duty-free privileges under the EU's Everything But Arms (EBA) scheme. Together, these factors pose substantial challenges to Bangladesh's export competitiveness, particularly in the apparel sector, which is highly reliant on the EU market.

The modelling results indicate that Vietnam's export growth to the EU is expected to accelerate, even with stringent rules of origin under the EVFTA. In contrast, Bangladesh is projected to experience challenging circumstances due to trade diversion effects and the erosion of tariff preferences. The apparel sector will be particularly vulnerable, facing an average tariff hike of 9.6 per cent under the Standard GSP or potentially higher if safeguard measures are applied. While Vietnam's gains are constrained by its dependence on imported fabrics and the complexities of meeting double-stage transformation requirements, the long-term trajectory suggests that its competitive position will strengthen as it continues to enhance domestic value addition and attract FDI.

For Bangladesh, the challenges presented by the EVFTA and LDC graduation highlight the urgency of strategic reforms and proactive engagement. Improving firm-level competitiveness, aligning with EU sustainability standards, and diversifying the export basket are critical to mitigating the adverse impacts. Securing GSP+ preferences offer a temporary reprieve but must be accompanied by efforts to negotiate long-term trade agreements, such as an FTA or CEPA, to maintain preferential access to the EU. Addressing structural constraints, modernising trade logistics, and fostering investment in high-value sectors will be essential to boosting export resilience and competitiveness.

While the short-term impacts may seem daunting, they also present an opportunity for Bangladesh to recalibrate its trade and industrial strategies. By focusing on reforms, innovation, and strategic partnerships, Bangladesh can not only navigate the challenges posed by the EVFTA and LDC graduation but also position itself as a competitive player in the evolving global trade environment.