

POLICY BRIEF

October 2024

EU Corporate Sustainability Due Diligence Directive: Way Forward for Bangladesh

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Abstract: The EU Corporate Sustainability Due Diligence (CS3D) Directive presents both challenges and opportunities for Bangladesh, particularly given the country's reliance on the EU as a major export market. This policy brief evaluates the implications of the CS3D for Bangladesh's garment sector, highlighting key compliance challenges, including a lack of technical expertise, resource constraints, increased costs without corresponding improvements in export prices, and ineffective oversight mechanisms. While rising compliance costs and potential tariffs following LDC graduation pose significant risks to competitiveness, the policy brief underscores the transformative potential of improved compliance in aligning with global sustainability standards and enhancing export resilience. It advocates for a locally driven compliance agenda that addresses systemic weaknesses across sectors, emphasising collaboration between the government, the private sector, and development partners. By framing compliance as an investment rather than a cost and integrating it into national policy priorities, Bangladesh can position itself as a responsible and sustainable trading partner, ultimately strengthening its trade and investment regime in an increasingly competitive global landscape.

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I. Background

When almost half of Bangladesh's exports, more than \$25 billion in 2023, are destined for the EU, new regulations from Brussels can ripple through the country's bustling garment factories. The recently introduced EU Corporate Sustainability Due Diligence Directive (CS3D), adopted by the European Parliament on April 24, 2024, is expected to shape Environmental, Social, and Governance (ESG) standards and global competitiveness in a country that has been marred with concerns about labour and human rights issues. CS3D mandates that companies, both within and outside the EU, engage in thorough due diligence to examine, prevent, and mitigate their negative environmental and human rights impacts, both internally and across their supply chains.

The ambit of CS3D on human rights and the environment is vast, encompassing issues such as the prevention of child labour, slavery, labour exploitation, pollution, deforestation, and damage to ecosystems like excessive water consumption. The overarching aim is to ensure equitable treatment of workers, uphold freedom of association, guarantee a fair minimum wage, and implement measures to combat pollution and the depletion of natural resources. This directive is anticipated to bring about substantial transformations in corporate practices, compelling companies to reassess and potentially overhaul their business strategies, sourcing practices, supply chain management protocols, and even product design approaches to adhere to these new regulatory standards.

This policy brief sheds light on the key issues that are important in evaluating the implications of the EU Corporate Sustainability Due Diligence (CS3D) Directive for Bangladesh, with a specific focus on its garment industry, exploring the challenges and opportunities associated with compliance. It also advocates for a locally driven, strategic approach to improving compliance standards as a means of sustaining export competitiveness and fostering sustainable development.

II. The Compliance Conundrum

Despite its commendable goals, the practicalities of compliance are complex and multifaceted. Implementing the CS3D is no small feat, especially given Bangladesh's limited capacity in assessing, preparing for, and enforcing standard-related issues.

Challenges in measuring compliance: The vast scope of the EU's Corporate Sustainability Due Diligence Directive (CS3D) presents significant challenges for the Bangladesh garment industry, particularly in defining and measuring compliance. Factories often face arbitrary procedures and varied guidelines imposed by different buyers, adding layers of complexity. Although the industry is free of child labour, there remains ambiguity in defining other critical terms such as forced labour, environmental sustainability, and fair wages. For instance, despite the implementation of minimum wage legislation, determining what constitutes a "fair wage" in a country characterised by widespread low wages complicates the standard-setting process.

Complex supply chains and daunting oversight requirements: The garment industry's fragmented and intricate supply chains exacerbate compliance challenges. Ensuring adherence to CS3D standards requires tracking raw material origins, monitoring production processes, and verifying compliance with environmental and human rights standards across every stage of the supply chain. This level of scrutiny is particularly burdensome for smaller firms with limited resources and oversight capabilities, increasing the risk of non-compliance and the associated reputational damage.

Lack of technical expertise and resource constraints: Many Bangladeshi garment manufacturers lack the technical expertise necessary to meet CS3D standards effectively. Compliance involves conducting environmental impact assessments, developing risk management plans, and implementing sustainability reporting systems—tasks that require specialised skills and knowledge. Without adequate training and support, factories face significant difficulties in meeting these requirements. Building this expertise within the industry demands substantial investment in capacity-building initiatives, which is often a slow and resource-intensive process.

Progress amid challenges: LEED-certified factories: Despite these challenges, Bangladesh has made notable progress in sustainability. The country boasts 213 LEED-certified factories, vetted by the United States Green Building Council (USGBC) Leadership in Energy and Environmental Design—the highest number in the world. These achievements highlight the industry's potential to adopt sustainable practices. However, broader compliance with CS3D standards remains an ongoing challenge.

The role of the regulatory environment: The successful implementation of CS3D also depends on the strength and consistency of the country's regulatory framework. While there have been improvements in some areas, enforcement remains inconsistent across standards and factories. Aligning national laws with CS3D requirements is essential to establish a clear legal basis for compliance and effective enforcement.

Squeezed margins and unfair pricing: While the garment industry in Bangladesh has made significant strides in improving compliance, many stakeholders contend that buyers have yet to reciprocate these efforts with equitable pricing practices. Instead, intense competition among manufacturers has perpetuated downward pressure on margins, thereby constraining their ability to sustain, let alone enhance, compliance initiatives. According to the International Trade Centre (ITC), garment producers in Bangladesh receive prices that are 32% to 83% lower than those paid to suppliers in other countries. Furthermore, even after adjusting for variations in product quality, evidence suggests that Bangladeshi exporters remain disadvantaged by persistently lower pricing structures, a reality that erodes their financial capacity to invest in further improvements.

LDC graduation and the double burden of compliance and tariffs: Compounding these challenges, Bangladesh's anticipated graduation from Least Developed Country (LDC) status in 2026, followed by a three-year transition period, will result in the loss of duty-free access to the European Union (EU) market. Although the country is striving to qualify for the EU's GSP+ scheme—which

provides duty-free access to 66% of EU tariff lines, including textiles and clothing—the draft provisions present formidable obstacles. Specifically, these provisions stipulate that GSP+ beneficiaries cannot retain preferential access for products exceeding 6% of total EU imports and 37% of GSP-covered imports within the same product category. Given Bangladesh’s considerable share in these categories, these restrictions, if enforced without amendment, would impose an average tariff of 11.5% on its garment exports, creating an additional burden for an already strained industry.

Taken together, the financial pressures of compliance with CS3D and the looming prospect of elevated tariffs represent a dual challenge that threatens the long-term competitiveness of Bangladesh’s garment industry. While compliance enhances sustainability and aligns with global consumer expectations, it also introduces significant costs that are not yet matched by higher price realisations. Simultaneously, the potential withdrawal of duty-free access would erode the price advantage currently enjoyed in the EU market. These intertwined challenges underscore the imperative for coordinated policy responses, both at the national level and in partnership with key trading blocs, to safeguard the sector’s competitiveness and sustainability.

Balancing compliance demands with socio-economic realities

Despite its good intent, punitive measures against non-compliant firms, such as order cancellations or declarations of non-compliance, could disproportionately affect workers. This is particularly critical as Bangladeshi firms face mounting competitive pressures stemming from the country’s imminent graduation from Least Developed Country (LDC) status, which will result in the loss of trade preferences and the reduction of policy space for government support, such as export subsidies. Providing a reasonable transition period for compliance and allowing flexibility in addressing specific challenges are, therefore, essential to mitigating these adverse impacts.

In response to increasingly stringent labour and environmental standards, many firms are likely to accelerate investments in automation. This trend, arguably catalysed by the Rana Plaza incident, has already had profound implications for the sector. Between 2010 and 2023, apparel export earnings increased fourfold, from approximately \$10 billion to \$40 billion, yet employment in the sector has stagnated at around 3.5 million workers. Moreover, this technological shift appears to be linked to the defeminisation of the workforce, as the share of women in export-oriented apparel sector employment dropped to 39% by 2022, according to official labour force surveys. This contrasts sharply with perceptions from two decades ago, when women dominated the workforce. Between 2017 and 2022 alone, 0.18 million women’s jobs were lost in the sector. While the reasons for this trend remain unclear, it is plausible that many women’s roles, often involving repetitive tasks requiring extended hours, are more easily automated. Additionally, technological advancements may disproportionately benefit men, given women’s relatively weaker educational backgrounds and the socio-cultural barriers limiting their progression to supervisory roles associated with operating machinery.

Bangladesh's dual economic structure further complicates compliance efforts. Exporting firms are often held to higher standards, while non-exporting firms, many of which operate informally, exhibit far poorer compliance records. This disparity exacerbates labour market vulnerabilities, particularly in non-exporting sectors, where reduced demand for labour—driven by stringent regulations—could aggravate precarious economic conditions. Such unintended consequences are emblematic of the "Cobra Effect," a phenomenon named after a colonial Indian policy that, in attempting to reduce the population of cobras through bounties, inadvertently encouraged cobra breeding and worsened the problem.

To mitigate these challenges, the EU and its institutions must recognise that compliance with the CS3D requires significant technical and financial support. This assistance is essential for raising awareness among entrepreneurs, managers, and policymakers, strengthening enforcement mechanisms, and ensuring meaningful compliance across industries. More importantly, the EU must collaborate closely with the government of Bangladesh, private sector enterprises, and other stakeholders to enhance compliance standards across the broader economy. Failure to address these systemic issues risks perpetuating 'compliance leakage,' undermining the very workers the CS3D aims to protect.

III. Way Forward for Bangladesh

While the challenges associated with implementing the EU Corporate Sustainability Due Diligence (CS3D) provisions are significant, it is imperative for Bangladesh to carefully evaluate the broader merits of improved compliance. In the current context, where compliance standards remain weak across many sectors, fulfilling the CS3D provisions may represent an aspirational goal rather than an immediate reality. However, given the critical importance of the EU as an export destination, the directive could serve as a valuable impetus for initiating necessary reforms. That said, a compliance agenda driven by local priorities and underpinned by a clear understanding of domestic needs has the potential to act as a far more powerful catalyst for sustainable transformation. By aligning efforts with national development goals and leveraging the CS3D as a benchmark, Bangladesh can formulate policies that not only address external requirements but also deliver tangible benefits for its economy and workforce. Such a locally driven approach should form the cornerstone of policy design and implementation, ensuring that compliance efforts are both contextually relevant and strategically impactful.

- **Role of compliance as a catalyst for export competitiveness and sustainable development**

While rising compliance costs remain a significant concern for businesses, particularly in Bangladesh's garment sector, compliance must be recognised as an essential vehicle for sustaining and enhancing export competitiveness. In a global market where consumers, brands, and retailers are increasingly prioritising compliance and sustainability, non-compliance risks losing market share and reputational damage. Improved compliance not only ensures access to key markets like the EU but can also elevate Bangladesh's standing as a responsible and reliable sourcing destination,

ultimately improving price prospects. As global buyers shift towards sustainability-conscious procurement, meeting these standards will likely become a baseline requirement rather than a competitive advantage.

It is worth noting that while rules and regulations in developed countries are seen as one of the main drivers of improved compliance—often regarded as unrealistic—in many developing country contexts, there is evidence of many multinational corporations proactively pursuing higher standards. For instance, motivated by the global greening initiatives, many brands and retailers are taking measures to tackle their environmental footprints. Amongst others, H&M, one of the largest buyers of garment items for Bangladesh, has committed to reducing emissions by 56 per cent by 2030 (from the 2019 baseline) and reduce freshwater usage by 30 per cent by the same timeline (from the 2022 baseline) in their production of garment products. These improved standards are being demanded from their entire supply chains. Similarly, Nike, LEVI, Adidas and many others have specified similar targets. Therefore, improved compliance is becoming increasingly a global trend, becoming a determinant of export success.

Although the garment industry often draws the most attention due to its export dominance, compliance issues in other sectors are most likely to be worse and it is equally to strengthening compliance across all industries is crucial to avoid selective progress and ensure a uniformly competitive trade and investment environment. By addressing systemic weaknesses, Bangladesh can attract foreign investment and diversify its export base. Thus, improving compliance must be viewed not as an additional cost but as an investment in the country's long-term economic resilience and global competitiveness.

- **Promoting compliance as a domestic agenda**

Positioning compliance as a domestic, home-grown agenda is vital. A nationally driven approach underscores the country's commitment to labour rights, environmental sustainability, and global trade standards. This is particularly important in countering the perception that compliance is an externally imposed obligation. By internalising these standards, Bangladesh can proactively demonstrate its commitment to and making progress towards sustainable trade practices, rather than merely responding to external pressures.

Furthermore, embracing compliance as a domestic priority ensures that the benefits extend beyond export-oriented industries. Improved labour conditions and environmental safeguards can uplift the broader economy and enhance the quality of life for workers and communities. This approach also helps create a uniform regulatory framework that applies to both exporting and non-exporting sectors, reducing the risk of compliance leakage and ensuring consistency in enforcement.

To operationalise this vision, Bangladesh should consider preparing a detailed national strategy for compliance. This strategy should outline clear goals, timelines, and responsibilities, while also identifying the resources required to build capacity across industries. By doing so, the country can ensure a structured and coordinated approach to meeting international standards, supported by both government initiatives and private sector engagement.

- **Collaborative and policy approaches in promoting compliance**

Promoting compliance with the EU CS3D can benefit significantly from collaborative efforts, such as public-private partnerships. The government can play a pivotal role by offering targeted incentives to encourage improved compliance with environmental and labour standards. Such incentives might include tax benefits, grants for capacity building, or subsidised training programs for factory management and workers. These measures not only enhance the capability of firms to meet stringent compliance requirements but also create a business environment that fosters sustainable practices.

Crucially, providing compliance incentives is likely to have a more substantial impact on export competitiveness in the medium to long term compared to direct export subsidies. While export subsidies might deliver immediate price advantages, they are increasingly being challenged under WTO rules, making them unsustainable for a country like Bangladesh, which is on the verge of graduating from its Least Developed Country (LDC) status. In contrast, support for improved compliance can be structured in a manner that aligns with WTO regulations, thereby avoiding potential trade disputes or sanctions. Moreover, compliance-oriented incentives often attract support from the EU and other development partners, which can amplify their impact.

Adopting a compliance-first approach has the added advantage of bolstering Bangladesh's reputation as a responsible trading partner. This not only secures existing market access but also makes the country's trade and investment regime more attractive to foreign investors. Firms that meet rigorous standards are often perceived as more reliable and sustainable, providing long-term assurance to buyers and investors alike.

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