Global Momentum on Climate Change and Emerging Trade and Investment Regimes: Implications for Bangladesh

Mohammad A. Razzaque[*]
Siddique Zobair

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[*] The authors are respectively, Chairman, Research and Policy Integration for Development (RAPID), and Director, Policy Research Institute (PRI) of Bangladesh; and Ex-Additional Secretary and Member, Sustainable and Renewable Energy Development Authority, Ministry of Power, Energy and Mineral Resources, Government of the People's Republic of Bangladesh. This paper has benefitted from comments and suggestions received from two rounds of expert group meetings organised by UNDP. The authors gratefully acknowledge further comments and suggestions received from Professor Mustafizur Rahman (Centre for Policy Dialogue). Discussions with Khurshid Alam, Arif Mohammad Faisal, and Muhammad Jahedul Huq of UNDP generated extremely valuable inputs used in the paper. Excellent research assistance was provided by Jillur Rahman, Mahir Musleh and Farah Marzan. Special thanks are due to Dr Badri Narayanan Gopalakrishnan of the University of Washington-Seattle for his assistance with and reviewing the carbon modelling results. Any views expressed and limitations associated with the paper are those of the authors and should not be attributable to the individuals and institutions named above.

Executive Summary

Background

The long overdue efforts to tackle greenhouse gas (GHG) emissions to rein the pace of rising temperature in are finally shaping up firmly. This upsurge in climate change actions brings a new spotlight on the development prospects for a country like Bangladesh. Being one of the most climate vulnerable countries, it desperately wants the global community to pursue robust actions to restrict climate change consequences to a minimum. However, the push for such proactive measures will inevitably affect the current international trade and investment regimes, requiring Bangladesh to adapt and adjust fast to remain a competitive exporter in the global market and to attract investment.

The Great Greening Drive

In a major paradigm shift, many countries have recently undertaken unprecedentedly bold commitments to cut their CO_2 emissions drastically to become 'net zero' carbon economies over the coming decades. The return of the United States to the Paris Agreement 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 EU has committed reducing net GHG emissions by at least 55 per cent by 2030 (compared to 1990 levels) and becoming climate-neutral by 2050. China, the world's largest emitter, has set up its ambition to become a climate leader and to transform itself into a carbon neutral economy by 2060.

During the past two decades, many advanced economies have shown a remarkable decoupling of economic growth from CO_2 emissions in which those countries' economic activities continued to expand with a falling level of emissions. Since the developing countries had started industrialising much later, their GHG emissions are expected to rise. Nevertheless, different countries are employing different approaches and more than 170 countries have now introduced national policies and laws on climate change adaptation to address impacts including the rising risks of extreme events such as floods and droughts.

The current momentum in worldwide climate actions is set to change global trade policy regimes in a remarkable manner. Until now, different measures to protect environment in different countries has caused international trade to undermine climate action efforts as emitters and polluters can change the location of firms to avoid restrictive measures. Contributing to around one-quarter global CO_2 emissions, international trade is coming under serious scrutiny. In an unprecedented attempt, the EU has now proposed measures to control GHG emissions within its own economy while tackling carbon leakage arising from its own climate change policies.

The EU Green Deal and its carbon border adjustment mechanism

The recently proposed EU Green Deal aims to make use of a so-called carbon border adjustment mechanism (CBAM) to internalise the cost of CO_2 in both domestically produced and imported goods with the objective of making the system compatible with WTO principles of dealing with all trading partners equally (non-discrimination) and treating imported and locally produced goods equally (national treatment). Under the CBAM, the EU wants to price the embedded carbon content in imports which will be equivalent to the price of CO_2 faced by domestic firms under the EU emission trading System (ETS). The CBAM, to be effectively enforced from 2026, will initially consider six high energy intensity sectors, viz., cement and glass, steel, aluminum, paper, petroleum and coal products, and chemicals and fertilizers. Additional sectors are likely to be brought under coverage at later phases.

Simulation exercises undertaken as part of this paper, using the Global Trade Analysis Project Energy-Environmental (GTAP-E) model, seem to suggest that initially the impact of the CBAM on Bangladesh's exports to the EU will be negligible. This is because the specified six sectors under carbon tax coverage contribute very little to Bangladesh's export earnings. However, the CBAM will add an additional pressure on exports after LDC graduation when Bangladesh will lose preferential (duty-free) market access. If CBAM extends to textiles and apparels, the combined impact of CBAM tariffs and post LDC tariffs could result

Bangladesh's apparel and total exports to the EU to decline by a quarter. An alternative simulation shows that if the price of CO_2 increases to $90 per tonne, and if comparator countries (i.e., China, India, and Vietnam) gain a significant efficiency in carbon emission reduction, the overall impact on Bangladesh's exports to the EU could be 6.9 per cent due to a possible introduction CBAM on textile and apparel items. Thus, failure to develop carbon offsetting mechanisms would impact exports.

As per the EU CBAM, extra-EU exporters already being subject to carbon reduction tax at the production stage will be treated differently at the border. If Bangladesh continues with no carbon action measures, its exporters will have to face higher carbon tax compared to its major comparators. More importantly, operation of carbon markets in other countries will encourage their firms to become more efficient. Effective carbon markets can also help attract foreign investments that are now more concerned about emissions.

Greening of the global investment regime

Investors and business enterprises are rapidly transforming by boosting their adaptation and mitigation practices to counter climate change. This is being reflected in all spheres: from multinational investors to development finance institutions (DFIs) to hedge funds to sovereign wealth funds (SWFs) and to credit agencies. The transformation is driven by multiple factors including a general shift in the attitude of consumers and investors towards achieving a sustainable future; pressure from various international campaigners and advocacy groups; push from governments and regulators; technological breakthroughs; and available profitable opportunities in providing sustainable products and services. The global investment regime is rapidly changing, shifting to a more sustainable and climate-friendly projects. All major investors are aggressively incorporating ESG issues into their investment and financing strategies. These shifts imply that any investment-attracting regime must provide adequate focus on climate change mitigation and adaptation support and regulatory framework. Bangladesh's track record in sound macroeconomic management thus needs to be complemented by environmental risk management activities in portraying an investment-friendly economy.

The emerging trends in global trade and investment regimes seems to suggest that the future success of Bangladesh's export-oriented readymade garment (RMG) industry will critically hinge upon ESG compliance. While the RMG sector, being a large and Bangladesh's most important export sector, is under scrutiny, ESG standards for other sectors—be it in the import-competing or export-oriented sectors—are considered to be far worse. Under such circumstances and given the changing global trade and investment regimes, attracting foreign investment and expanding exports, which Bangladesh needs badly given its impending LDC graduation, would be a daunting prospect unless serious consideration is given to improving ESG compliance.

Bangladesh's Energy Transition Efforts: Challenges and Opportunities

Despite having policies in place to address the long-term climate change vulnerability, the progress towards the transition to renewable energy remains subdued in Bangladesh. Against the target of achieving 10 per cent electricity generation from renewable sources by 2020 in the 7th FYP, the share of such energy had actually declined from 3.6 per cent in FY2015 to 3 per cent in FY2021. Bangladesh has both structural and policy-induced constraints to achieve the clean energy targets.

Bangladesh is strongly determined to reduce greenhouse gas emission as shown in the NDC commitments. In the updated NDC, Bangladesh intends to unconditionally reduce its greenhouse gas emission from some major sectors by 6.73 per cent (from the business-as-usual scenario) by 2030. Subject to technological development, knowhow transfers, and finance and investment support from the international community, Bangladesh has committed an additional 15.12 per cent reduction. Bangladesh commits to producing 911.8 MW of renewable energy using domestic resources and an additional 4115.3 MW subject to international support.

Bangladesh has some major natural and policy constraints in expanding renewable and clean energy. Geophysical characteristics and geographical location of the country is not much suitable for harnessing hydropower and geo-thermal sources. Onshore wind is likely to have limited scope to exploit while there has been no feasibility assessment of offshore wind prospects. Solar power appears to be the only practical technology for Bangladesh but a major barrier for solar PV expansion is land scarcity. Along with renewable energy generation, the current capacity and efficiency of transmission, distribution, and storage infrastructure remains a major constraint facing Bangladesh. Furthermore, policies to deal with huge shortage of electricity in the previous decade have generated excessive capacity in fossil fuel-based power production. Therefore, energy transition in the country would require a long-term investment flow across the entire supply chain along with a corrective policy support mechanism.

Way Forward for Bangladesh

The extraordinarily upsurging of global climate actions along with shifting trade and investment landscapes coincides with Bangladesh's critical development transitions given its impending graduation from the group of least developed countries (LDCs) in 2026 and ambition of becoming an upper-middle income country by 2031 having realized the Sustainable Development Goals (SDGs). Along with the loss of preferential market access after graduation, border carbon adjustment measures as well as ESG compliance are going to critically hinge upon the competitiveness of Bangladeshi firms in the very near future. It is thus high time to prepare for a post LDC international trade regime compounded by challenges of climate change adjustment measures. This paper thus provides a set of broad policy recommendations.

- Setting right perspectives about climate change mitigation and adaptation is critical for promoting international competitiveness. That Bangladesh has contributed very little to the current global climate crisis should not be a cause for lackluster efforts for transformation. The world economy is changing rapidly and a proactive adjustment to this process—by offering appropriate policy measures and establishing effective regulatory environment—will ensure a faster catch-up, enhancing overall competitiveness of the economy. Failure to adapt fast could trap a country into a stagnant or slow transition path with obsolete investment and production practices and thus weakened competitiveness.
- The challenge of any loss of tariff preference due to LDC graduation could be compounded by the CBAM. As the EU has announced its border carbon adjustment measures, other countries are likely to follow suit. Bangladesh's several comparator countries including China, India, and Vietnam, are adapting different carbon offsetting mechanisms including introduction of domestic carbon markets. Therefore, along with the preparation for LDC graduation, due attention must be given to prepare for border carbon tax measures.
- Improved technical capacity in assessing implications and building negotiation capacity for securing favourable terms and other international support measures can greatly help avoid sudden shocks and prepare better for the shifts in global trade policy regimes. Issues such as Bangladesh's very small contribution to global GHG emissions, impending LDC graduation, climate vulnerability, etc. need to be highlighted in international and bilateral forums and should be used in negotiating favourable terms out of any BCAM regimes of partner countries and adjustment support. This can generate some additional time for local industries to adapt, and technical and financial assistance in facilitating the transformation required.
- It is imperative to establish green credentials of the overall economy backed by strong policy commitments and effective implementation programmes. Many investors including big brands and retailers have placed a strong emphasis on curtailing GHG emissions from their entire supply chains. It is in this context that firm-level preparedness must be strengthened when local entrepreneurs want to be part of and/or consolidate their positions in global supply chains.
- Potentials of attracting foreign investment and expanding exports could be compromised unless serious consideration is given to improving ESG compliance. Improving the ESG record must be seen as a precondition for export success as climate change actions bring it under a refreshed spotlight.
- Progress towards energy transition must be given utmost priority. It is high time to consider bold measures with a timebound and accountable implementation process. Given the existence of numerous policy frameworks, a thorough review of the effectiveness of these interventions should be undertaken immediately. Enabling fiscal and financial policies with appropriate incentive structures backed by effective financing instruments to mobilize private sector funds and foreign investment should be helpful to promote electricity production from the renewable sector.

- In the light of global momentum for climate actions, many development finance institutions and other multilateral and private investors are eager to demonstrate the positive impact of their projects. As a climate vulnerable country with high population density, Bangladesh offers tremendous opportunities for high impact arising from green investments. A strong political commitment backed by well-articulated and executed greening initiatives of Bangladesh can attract foreign investment with cutting-edge technologies for dealing with GHG emissions.
- Making use of the policy space associated with LDC status for the remaining years before graduation and availing of the related international support measures for green transformation must be given immediate and careful consideration.
- Integration of various national strategies and policy frameworks is needed to ensure a clear focus on key priorities with coordinated actions. Policy efforts in Bangladesh are truly remarkable as various aspects of the country's development aspirations are regularly analysed with numerous policy documents being formulated and updated. A coherent approach is needed to establish interlinkages amongst all the relevant implementation mechanisms, identifying respective stakeholder responsibilities towards a common set of inter-related policy goals.

The changing global trade and investment landscapes will require Bangladesh to adjust accordingly to promote export competitiveness. Despite the associated adjustment challenges, it should be considered as an opportunity for green transformation of the economy, which will shape the future of world economic and business environments. Falling behind comparators in adjusting to new realities is no option for Bangladesh. Building on the current policy frameworks in the country, concerted efforts must be made to deal with the current constraints and to launch reinvigorated implementation programmes.