Towards A Transformed and Revitalized Trade and Economic Partnership with the EU

Policy Brief

This policy brief has been prepared by Mohammad A. Razzaque and Jillur Rahman. It is an outgrowth of a RAPID-FES collaborative project. Any limitations and/or views expressed in this paper are those of the authors and should not be attributable to FES.

August 2022

FRIEDRICH EBERT STIFTUNG Bangladesh

RAPID

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

Background

The European Union (EU) is as an indispensable trade and development partner for Bangladesh. It is the single largest export destination of the country comprising more than half of its total merchandise exports. It enjoys duty-free market access in the EU single market (27 countries) under its Everything But Arms (EBA) initiative. More than 80 per cent of all trade preferences for Bangladesh is due to this market alone and the corresponding preference utilisation rate is more than 97 per cent. Apart from providing preferential market access, the EU is also one of the most important donors of official development assistance (ODA) constituting one of the biggest sources of concessional loans and grants. While disaster preparedness risk reduction, building resilience, human resource development and social protection have been the traditional key priority areas of funding, the EU has also extended generous support in range of areas including for the Rohingya refugee response and pandemic containment efforts.

Several developments are surfacing triggering a reset of the Bangladesh-EU trade and economic relationship. These include, amongst others:

- The transition towards a new trade preference regime following Bangladesh's graduation from the LDC status and the resultant potential loss in market access conditions and concessional development assistance
- Loss of export competitiveness arising from other countries' trade agreements with the EU and associated trade diversion
- The implementation of the EU's Green Deal and its carbon border adjustment mechanism (CBAM)
- The increasing emphasis of the Environmental, Social, and Governance (ESG) factors affecting trade and investment prospects.

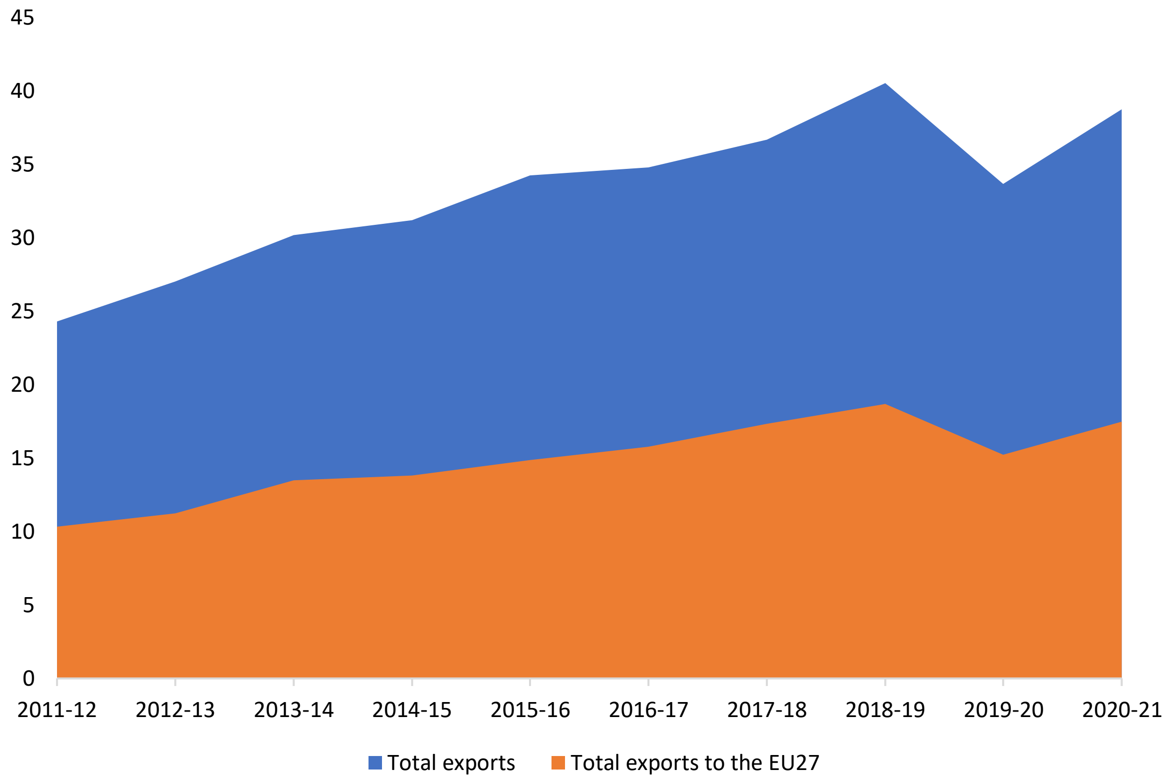
These factors call for an immediate policy attention to assess the major trends and emerging issues affecting the future of trade prospects with the EU. It is worth noting that recently a delegation of the European Parliament's Committee on International Trade raised the concern on human rights, labor rights, backlogs of cases at labor courts, EPZ labor laws, and wages and working conditions for the workers. If these issues are not addressed carefully, it is apprehended that Bangladesh might not be eligible for GSP+ trade preferences after its graduation from the group of LDCs.

Against this backdrop, this FES-RAPID study aims to develop evidence and informed inputs that can provide a basis for informed policy discussions. It will assess the emerging issues that are critical in transforming the trade and economic partnership with the EU in the coming years. The objective of this policy brief is to offer some preliminary evidence to facilitate a technical consultation with policymakers and experts to get their further insights into and ideas about what need to be done now urgently in promoting a development-oriented EU-Bangladesh engagements in the near future. The inputs from the technical consultation will be used to develop an in-depth policy paper.

Bangladesh's trade and economic cooperation with the EU

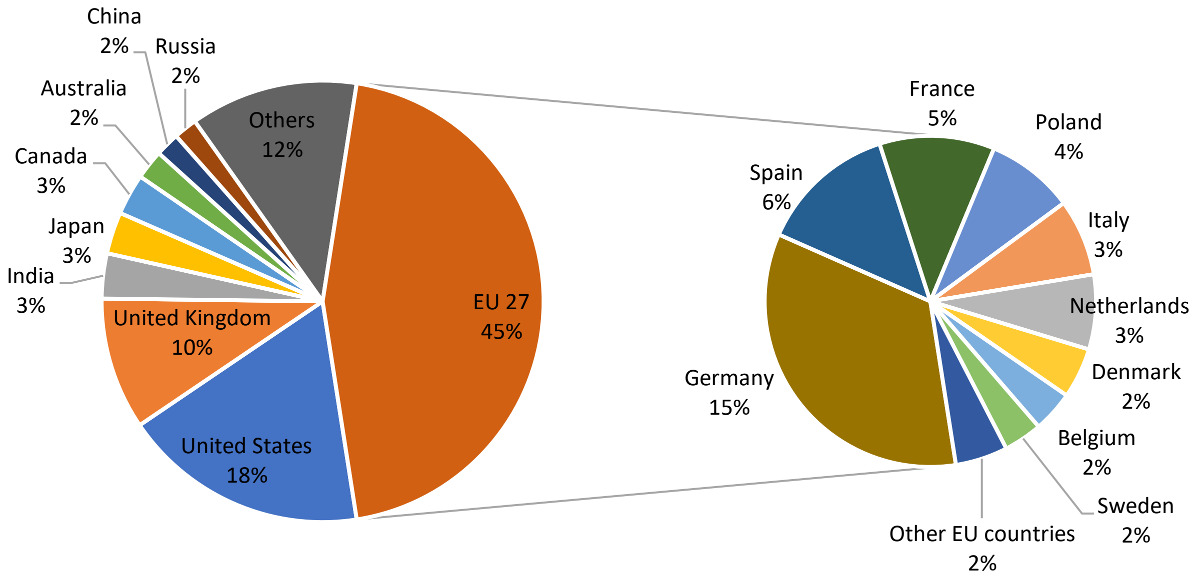
Bangladesh's total exports to the EU (27 countries) stood at $17.5 billion in 2020-21, increasing from just $2 billion in 2000-01 (Figure 1). Of this, $15.9 billion or more than 90 per cent is due to apparel items (readymade garments—RMG) only. The EU captures around 45 per cent of the country's total exports and more than half of apparel exports (Figure 2). Over the ten-year-period preceding Covid-19, Bangladesh's exports to the EU register a rise of more than 10 per cent per annum. Needless to mention that export success is overwhelmingly RMG-led, making Bangladesh as the second largest supplier (after China) of apparel items in the EU. Bangladesh captures a mammoth share of 20 per cent of EU apparel imports from the extra-EU countries (which is 30 per cent for China) (Figure 3).

Figure 1: Bangladesh's exports (billion $)



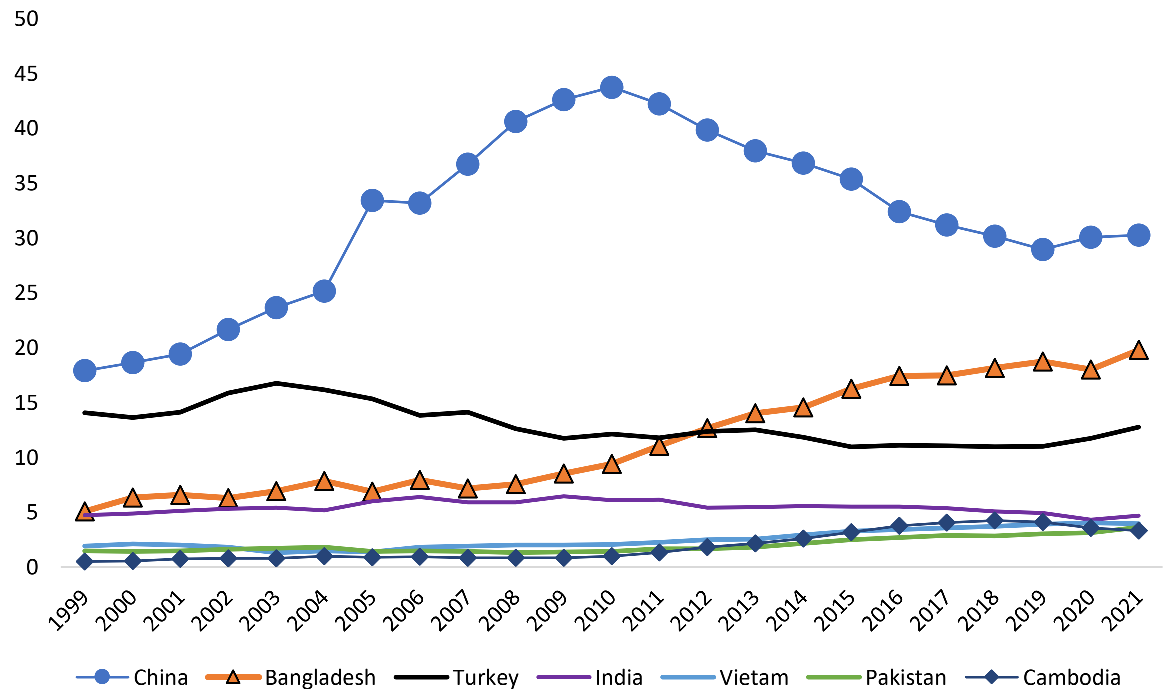
Source: Authors' presentation based on data from the Export Promotion Bureau (EPB) of Bangladesh.

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



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

Figure 3: EU (extra-EU) apparel market shares by selected suppliers (%)



Source: Authors' presentation using data from EU Comext.

Apart from exports, the EU is one of the most important donors of development assistance to Bangladesh. The cumulative ODA from EU institutions and individual EU countries over the past five years amounted to $2.3 billion, which is around 10 per cent of all ODA disbursements during the same time. More than one-third of EU ODA in Bangladesh is disbursed by EU institutions (Figure 5). Among the individual EU countries, Germany is the largest donor to Bangladesh, followed by Sweden, the Netherlands, France, and Denmark. The EU institutions and Germany are two among the top ten donors of Bangladesh; their combined assistance was higher than that of the United Kingdom in the past five years (Figure 6). Since 2019, the EU provided budgetary support to the government worth of €247 million to promote reform activities in and strengthen the national social protection system. Also, it has been providing an extended support in response to the Rohingya refugee crisis and pandemic containment efforts.

Figure 4: EU ODA disbursements to Bangladesh (million $)

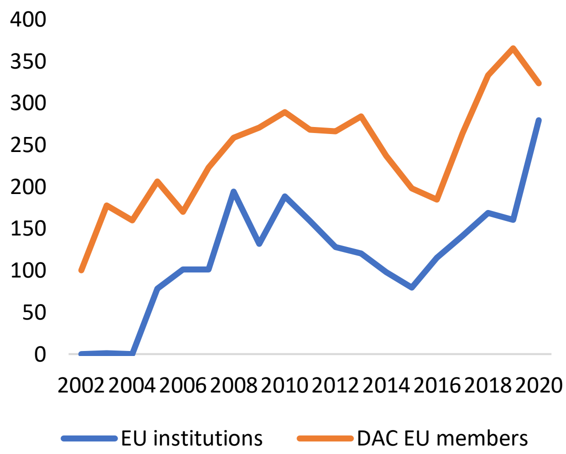


Figure 5: Major EU ODA donor of Bangladesh, average of 2016-20 (%)

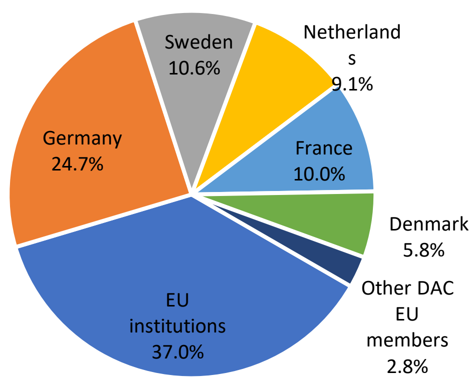
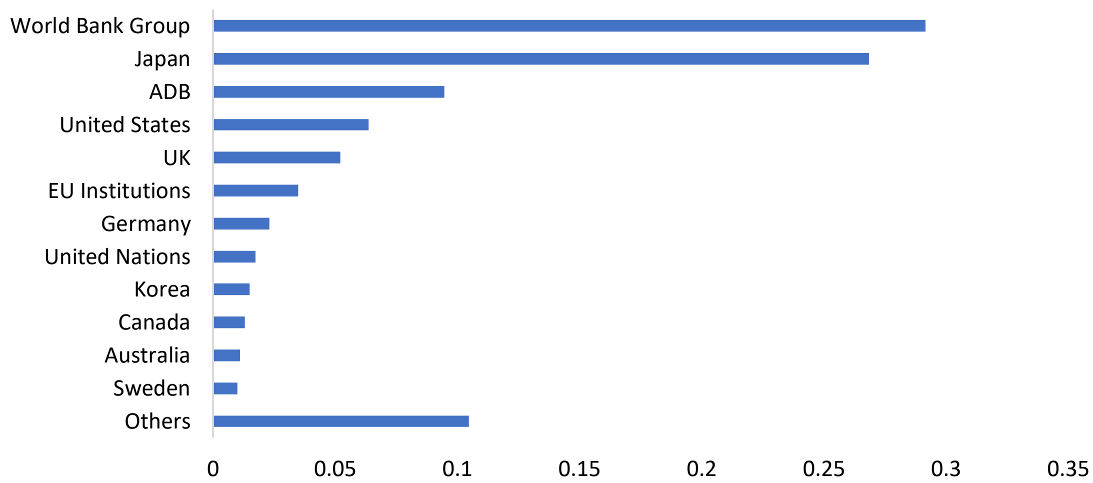


Figure 6: Major official donars of Bangladesh, 2016-20 (%)



The EU is also a source of foreign direct investment (FDI) in Bangladesh. Over the immediate past 5 years, the net FDI flow from EU countries was $3.5 billion (Figure 7), which is around a quarter of all such flows during the same period. The EU FDI stock in Bangladesh in December 2021 stood at more than 12 per cent of the total such stock. Among EU members, the Netherlands has the largest FDI stock in Bangladesh, followed by Germany, France, and Denmark (Figure 8). The Netherlands was the only EU member among the top 15 FDI partners of Bangladesh in the last five years (Figure 9).

Figure 7: Net FDI inflows in Bangladesh (million $))

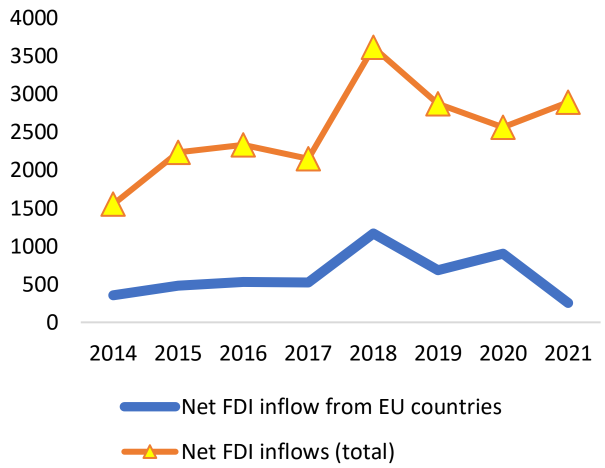


Figure 8: FDI stock in Bangladesh from major EU countries, as of December 2021 (million $)

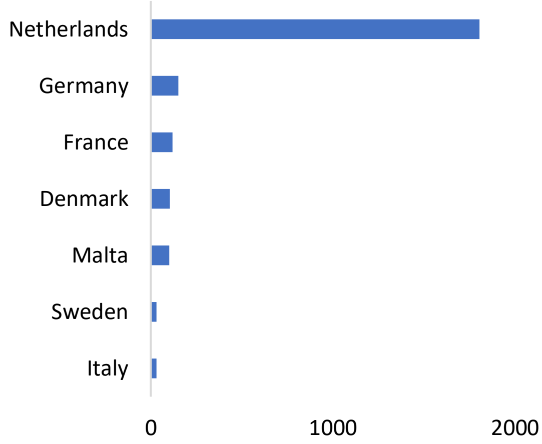
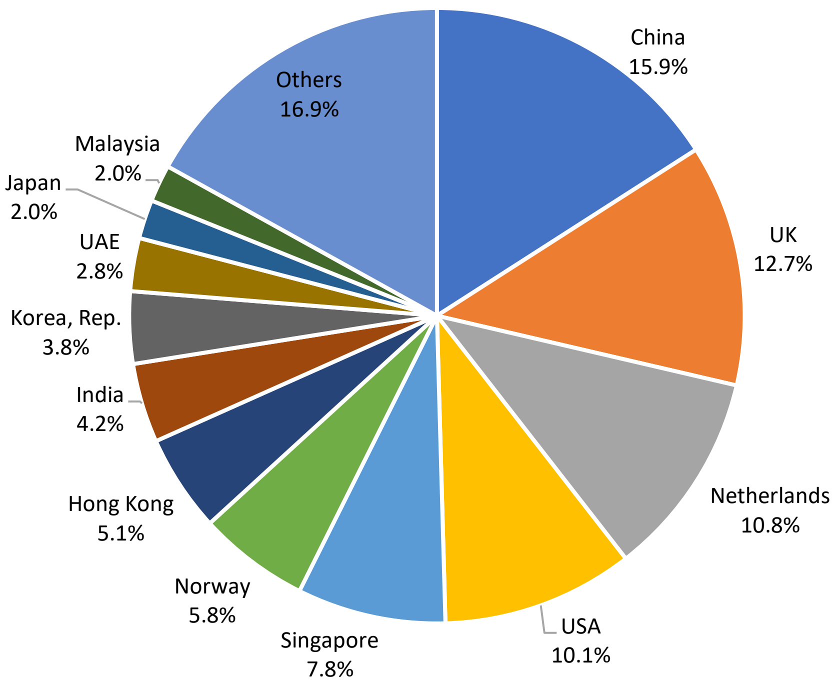


Figure 9: Major FDI (net) partners of Bangladesh, 2017-21 (%)



Source: Authors' presentation based on Bangladesh Bank data.

Emerging challenges affecting Bangladesh-EU trade and economic relationships

Bangladesh's LDC graduation and preference erosion in trade and development finance

As an LDC, Bangladesh enjoys duty-free market access for almost all items under the EU's everything but arms (EBA) initiative. Taking advantage of this tariff-free and quota-free market access under relaxed rules of origin (RoO) requirements, Bangladesh's exports to the EU expanded rapidly. Bangladesh is set to graduate from the group of least developed countries (LDCs) in 2026 while retaining all LDC trade preferences in the EU for another three years (until November 2029). Post-graduation, it will not be eligible for the EBA market access. The current EU generalised scheme of preferences (GSP) will expire in December 2023. The EU has announced its newly proposed GSP regime for 2024-34, which will be relevant for Bangladesh (from December 2029). It is important to understand the proposed scheme to assess the graduation implications on Bangladesh's exports in the post-LDC period.

Graduating Bangladesh can apply for GSP+, which is the second best preferential regime after EBA that offers duty-free access for 66 per cent of the EU tariff lines including apparel. According to the proposed GSP 2024-34, graduating LDCs will qualify for GSP+ preference contingent upon two criteria – the vulnerability criteria and the sustainable development criteria. The vulnerability criteria stipulate 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.[1] The sustainable development criteria imply that a beneficiary country must ratify and effectively implement 32 international agreements and conventions on human rights, labor rights, environmental protection and climate change, and good governance.[2]

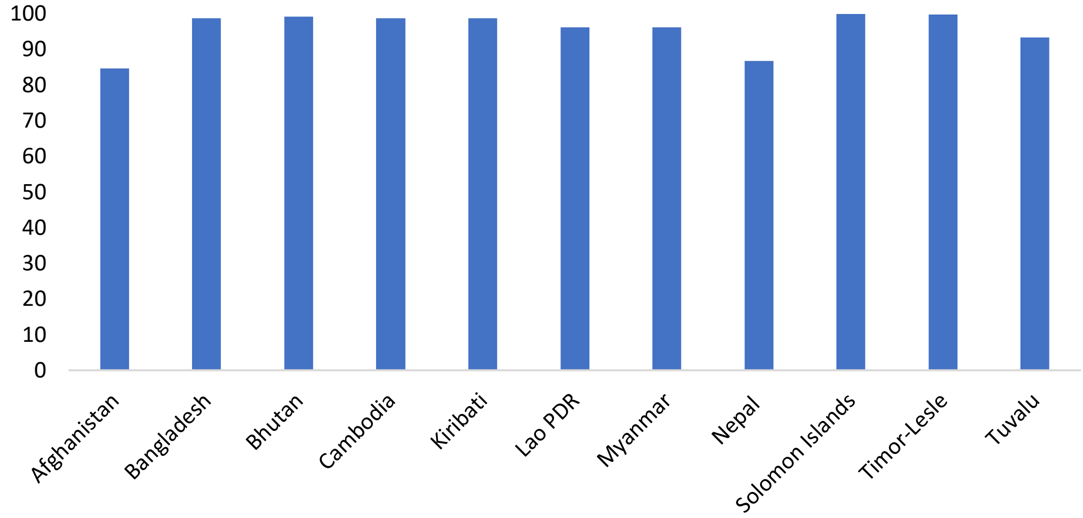
Bangladesh can meet the vulnerability criteria, as the seven largest sections of GSP-covered imports represent more than 75 per cent in value of its total GSP-covered imports to the European Union (Figure 10). Therefore, inclusion in GSP+ depends on ratification and effective implementation of the pre-specified 32 international conventions.[3]

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

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

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

Figure 10: Share of the country's seven largest GSP-covered products to the EU (%)



Source: Razzaque (2022)

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

Even if the graduating Bangladesh is included in GSP+ upon complying with the international conventions, it is likely that apparel exports will be subject to EU safeguard measures, resulting in exclusion from any preferential treatment.[4] According to EU provisions on "Safeguards in the Textile, Agriculture, and Fisheries Sectors" (Article 29 of the proposed EU GSP), clothing products from a GSP+ beneficiary will not receive preferential access if the share of the relevant products is above 6 per cent of total EU imports of the same products and exceeds the product graduation threshold during a calendar year.[5] The safeguard mechanism on these products will not apply to EBA recipients, nor to

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

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

other GSP recipient countries with a proportion of relevant products that do not exceed 6 per cent of total EU imports of the same products (Article 29, paragraph 2 of the proposed EU GSP 2024-34).

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

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

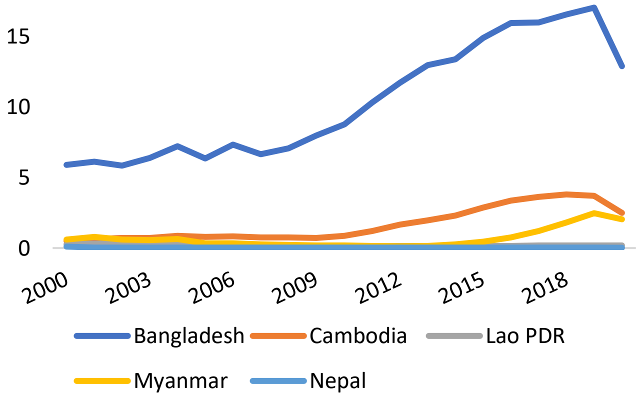
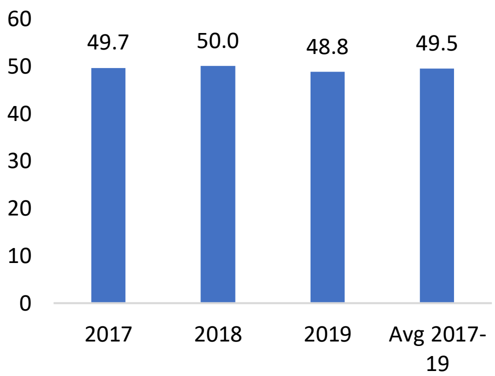


Figure 12: Bangladesh's exports under GSP section S-11b (% of GSP covered imorts in the EU)



Source: Razzaque (2022)

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

Graduation would imply stricter rules of origin to benefit from the preferential access. Under EBA, LDCs can benefit from market access with a single-stage transformation (i.e., from imported fabric to apparel making). The EU derogation of RoO requirements for textile and clothing for LDCs in 2011 from double to single-stage transformation reinvigorated the supply response from Bangladesh, especially for woven garments. Post-graduation, to qualify for trade preferences (either for GSP+ or Standard GSP) clothing items need to go through ‘double transformation, (i.e. preference-seeking countries will have to prove that they can produce fabrics and the domestically produced fabrics are used in making garments). Bangladesh has strong backward linkages for knit garments. However, a relatively weak backward linkage will be a major issue for availing preferential treatment for woven garments based on double-stage transformation. However, if Bangladesh’s apparel items attract safeguard measures and do not benefit from tariff preferences, there is no need to comply with RoO conditions.

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

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

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

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

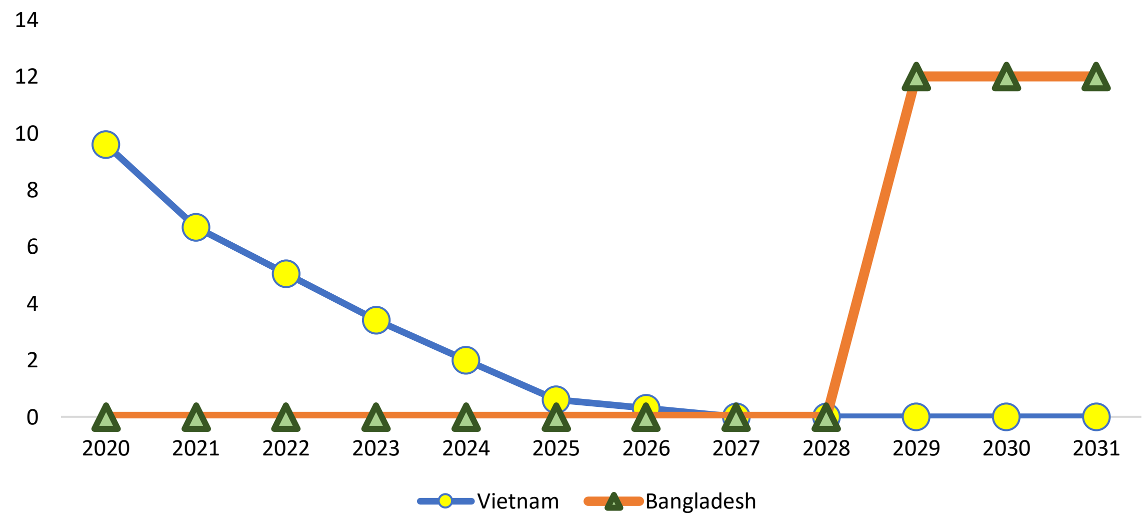
Loss of competitiveness arising from other countries' trade agreements with the EU

Recently a growing number of countries participate in bilateral and multiple preferential trade agreements (PTAs). These trade agreements allow member countries to have preferential market access either on duty-free or at a concessional tariff rate basis. While graduating LDCs may lose their most liberal unilateral trade preferences, other nations may gain more competitiveness as a result of free trade agreements, making them more appealing supply sources.

Currently, several trade negotiations are underway, and few have been signed in recent times. Among others, the EU-Vietnam Free Trade Agreement and the Investment Protection Agreement, and EU-Singapore Trade and Investment Agreement were signed and made effective. The EU-Vietnam FTA entered into force in August 2020. The tariff reduction provision in the EVFTA shows that the EU will eliminate the tariff on 99 per cent of exports of Vietnam to the EU within the transition period. The tariff on apparel will be cut to zero in seven years from its entry into force. This implies that Vietnam will face its tariff on clothing exports to the EU gradually declining to zero from the average rate of 9.6 per cent currently. Approximately at the same time, Bangladesh after graduation and a three-year transition period will face a tariff increase from zero to about 12 per cent (Figure 13) if it encounters the safeguard measures under the new EU GSP proposal 2023-34. The high tariff on Bangladesh will affect its competitiveness in this market while giving Vietnam a competitive edge under zero tariff. This will likely to cause a considerable trade diversion effects for Bangladesh, making it less competitive relative to Vietnam. This will make Vietnam an attractive source for apparel imports to the EU. It is important to highlight that Vietnam will need to meet the double-stage transformation rules of origin for apparel to benefit from the tariff preferences under the EVFTA. Due to limited backward linkage to the apparel sector in Vietnam and high dependence on textile imports from China, the exporting firms would face challenges to benefit from the EU trade deal.

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

Figure 13: Tariff implication on apparel products for Bangladesh and Vietnam in the EU market



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

There are several other negotiations ongoing including India-EU Free Trade Agreement, EU-Indonesia FTA, etc. These are expected to cause trade diversion from non-members to FTA partners. Any bilateral or multilateral engagements of other countries with major trading partners of Bangladesh could weaken the competitiveness of the later.

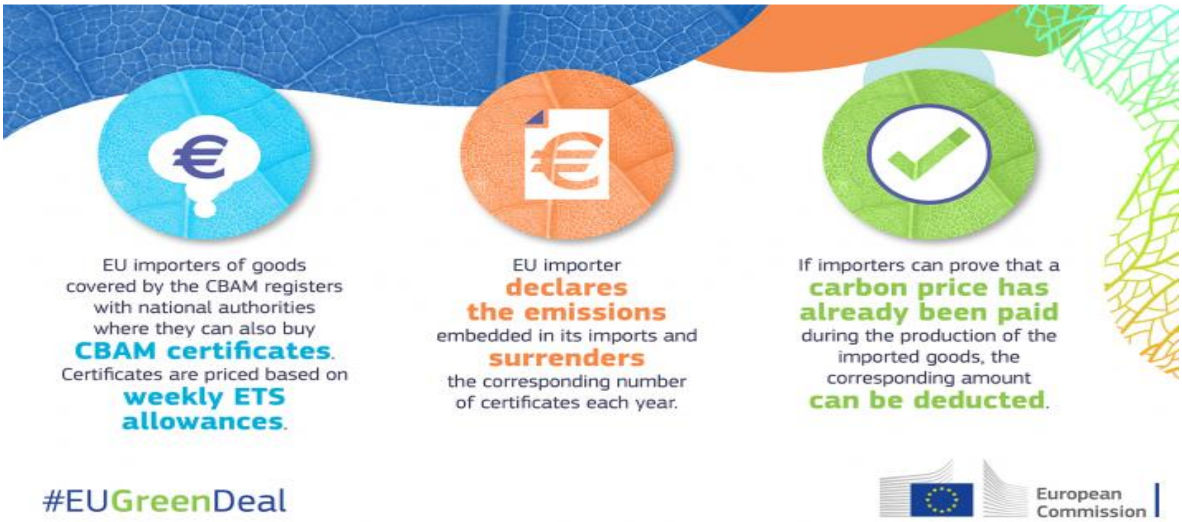
The EU green deal and carbon border adjustment mechanism (CBAM)

The global greening initiatives witnessed a major paradigm shift in recent years as economies undertook unprecedentedly bold commitments to reducing GHG emissions and adopting low-carbon sources for energy supply to align themselves with the objectives of the Paris Agreement. 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 great greening drive is firmly set to bring about a rapid transformation of international trade and investment regimes. As the advanced economies undertake bold emission reduction targets, they aim to redesign their trade policies for tackling carbon leakage to protect the competitive advantage of their own domestic sectors and in the process reduce global emissions.

One such major development is the EU Green Deal which intends to make the European Union a carbon-neutral market by 2050. The deal aims to develop a carbon border adjustment mechanism (CBAM) to internalise the cost of CO2 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).

Since 2005, the EU has maintained an emission trading system (ETS) to reduce greenhouse gas emissions for high carbon-emitting sectors on the basis of the cap-and-trade principle. Under the CBAM framework, the EU wants to price the embedded carbon content in imports which will be equivalent to the price of CO2 faced by domestic firms under the EU emission trading System (ETS). Conversely, if non-EU exporters can establish that they have already paid a price for the carbon used in the production of their goods, the corresponding cost can be deducted from EU importers (Figure 14). The CBAM will initially apply only to a selected number of goods at a high risk of carbon leakage, viz., cement, iron and steel, aluminum, fertilizers, and electricity, and will be operational from January 2023. Additional sectors are likely to be brought under coverage at later phases. In the transitional period of 2023-25, importers will have to report emissions embedded in their goods without paying a financial adjustment. From 2026 onwards, EU importers will have to pay for CBAM certificates.

Figure 14: The initial operational framework of the CBAM



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

Initially, the CBAM is not expected to cause any major concern for Bangladesh as the five sectors considered for a carbon tax are not among the major exports of the country. However, it is almost certain that the coverage of border measures in the EU will expand. In the current EU proposals, LDCs and some other small island developing states (SIDS) are likely to be exempted from the border carbon tax. The full implementation of the CBAM will coincide with Bangladesh LDC graduation timeline in 2026. If the coverage of CBAM is expanded to consider textile and apparel, Bangladesh will face post-LDC tariff hikes and CBAM charges, thus could pose as double trouble for its exports.

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

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. Currently, there exist no effective regulations in Bangladesh on carbon emission by the industries, and neither does any carbon tax initiative. On the other hand, its major comparators including China, India, and Vietnam, have either already established or are in process of developing carbon market. The operation of carbon markets in other countries will encourage their firms to become more efficient and attract more foreign investment. If Bangladesh continues with no carbon action measures, its exporters will have to face a higher carbon tax compared to its major comparators.

Environmental, Social, and Governance (ESG) compliance and implications for trade and investment

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

As consumers' raising awareness of climate change issues is carefully taken into consideration in supply chain management issues, environmental, social, and governance (ESG) issues are becoming ever more major components of international commerce and corporate activity. There is evidence that a sizable and increasing percentage of customers are emphasizing sustainable consumption. According to reports, up to 90 per cent of European consumers claim that the sustainability of items influences their purchasing decisions (Oney, 2020). Nearly one-third of American customers have been found to make some attempt to buy from companies that are committed to minimizing their environmental harm in the wake of the COVID-19 epidemic.

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

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

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

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

EU corporate sustainability and supply chain regulations

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

The due diligence is applicable for EU companies with at least 500 employees and a global net turnover greater than EUR 150 million, or non-EU companies that generate a turnover of at least EUR 150 million in the Union each year. Also, EU companies operating in sectors at high risk of human rights and environmental concerns including textiles and leather manufacturing, agriculture, forestry, fisheries, minerals, and mining, with at least 250 employees and generate a turnover of more than EUR 40 million, and non-EU companies that generate a turnover between EUR 40 million from their EU operations.

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

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

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

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

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

The supply chain laws in the EU and individual member states may affect businesses in the developing countries that supply to the EU. Compliance with the EU due diligence is applicable for all "established business relationships", whether direct or indirect along their entire supply chain and is not mainly limited to the direct suppliers. Under this clause, companies will have to monitor their entire supply chain whether suppliers are violating environmental, climate, and human rights. This also applies to those outsides of Europe. Companies may request particular due diligence papers from suppliers and sub-contractors to ensure the standards. Therefore, non-EU businesses may have to comply with the directive. According to a study by the Institute of German Economy (IDW), to comply with the supply chain laws, about one-fifth of German companies are planning to contract with suppliers in countries with greater human rights, labour, and environmental standards.[6] Another study by the same institute indicates that the France Duty of Vigilance Act is going to be associated with a lower level of trade. The EU countries are important export destinations and a major source of investment for many emerging developing countries including Bangladesh. Therefore, compliance with the supply chain laws in the EU is likely to affect export and investment in Bangladesh.

Way forward for Bangladesh

The EU is the one of most important trade and development partners. Bangladesh's export success until now to a large extent is due to preferences received in the EU. The impending changes in policy landscapes arising from the upcoming LDC graduation could be a defining feature or tipping point to significant changes in bilateral trade and economic cooperation. Policymakers and stakeholders need to have a proper appreciation of the approaching critical juncture of the relationship with the EU. It is important to develop a national-level consensus on the options about emerging issues and any policy shifts in the EU so that Bangladesh can continue to sustain and productive and beneficial bilateral relationship.

There are currently no informed policy discussions on the urgent need for a changed or transformed and revitalized relationship with the EU. Sensitizing the decision-makers and exporters, among other stakeholders, to the new realities and trends that will affect the future of the trade and investment relationship between the EU and Bangladesh is a priority task.

The above discussion seems to suggest that the ongoing developments in the EU policy landscape will have a significant impact on Bangladesh's trade and development cooperation with the EU. If proper action plans to address the emerging issues are not undertaken, Bangladesh's exports to the EU could come under serious pressure. Therefore, it is important to develop a longer-term strategy and action plan for strengthening Bangladesh-EU relations. The strategy and action plan should be developed based on proper needs assessments including the adjustment measures that need to be undertaken.

It seems that Bangladesh's apparel products may not be eligible for GSP facilities in the EU. On the other hand, its major competitors, Cambodia, Pakistan, Sri Lanka, and Vietnam will get duty-free market access facilities for apparel exports under the GSP arrangements and bilateral trade deals. This will cause a significant loss in competitiveness for Bangladeshi firms. Therefore, industrial upgradation policies should be adopted to improve firm-level business and operational practices to boost

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

competitiveness. Tackling the high cost of doing business and investing in connectivity and trade facilitation measures will be important to boost competitiveness. Sustainable production practices of the exporting firms, ensuring conformity with international standards, and adopting ESG-related compliances will be important determinants for export success in the future. Any improvements in these areas will contribute to the improved competitiveness of exporting firms. These are the areas where Bangladesh can also seek adjustment and competitiveness-building support from the EU and other multilateral donors.

Many policy analysts stress the need of establishing a trade agreement with the EU. Given its consistent economic growth performance, which places Bangladesh among the largest 30 economies, it is suggested that other trading partners will consider it a significant partner for a trade agreement. However, Bangladesh lacks a credible track record for undertaking and sustaining major policy reforms in such areas as trade, industrial and investment policies, intellectual property, and environmental protection that are now considered most essential for negotiating a trade agreement with any major economy in the world.

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