

## **Fifty Years of EU-Bangladesh Partnership: Charting Ahead on A Legacy of Success**

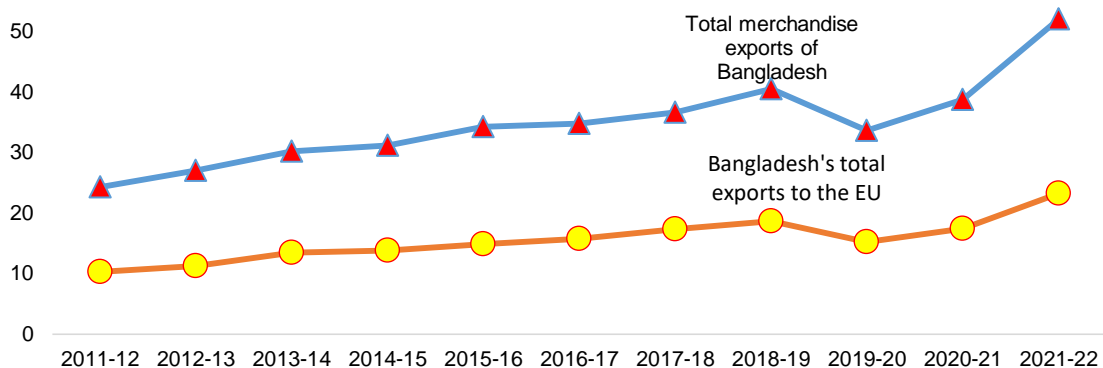
### **Background**

This year marks the 50<sup>th</sup> anniversary of the establishment of Bangladesh's diplomatic relations with the European Union (EU). Over the past five decades, the EU has emerged as an indispensable trade and development partner. It is by far the largest export market, as almost half of Bangladesh's merchandise exports are destined for the EU. Taking advantage of the *Everything But Arms* (EBA) initiative—designed for providing preferential duty-free and quota-free market access of goods originating from the least developed countries (LDCs), Bangladesh's combined exports to the EU expanded rapidly from just US\$2 billion in 2000-01 to \$23.2 billion in 2021-22. In value terms, more than 80 per cent of all Bangladesh's exports that receive any tariff preferences is obtained from European markets Bangladesh has been the single largest beneficiary of EU LDC-specific trade preferences.

Along with its contribution to trade, the EU has been one of the most important development partners as well. It provides generous budget support to the government of Bangladesh, supports numerous social and physical infrastructure projects, and is a critical source of technical assistance in a wide variety of areas.. Duuring 2017-21, the cumulative ODA from EU institutions and individual EU countries amounted to \$2.3 billion, which is around 10 per cent of all official development assistance (ODA) disbursements during the same period.

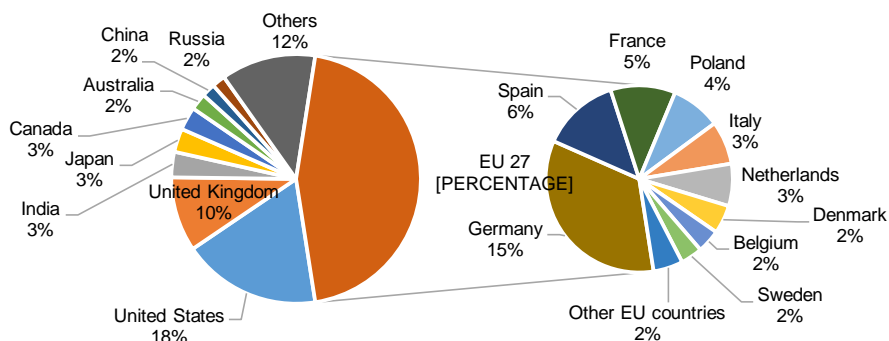
The EU is also a major source of foreign direct investment (FDI). Between 2017 and 2021, the net FDI flow from EU countries was \$3.5 billion, accounting for about a quarter of all such flows into Bangladesh during the same period. The FDI stock in the country due to the EU is more than 12 per cent of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

**Figure 1: Bangladesh's exports (billion \$)**



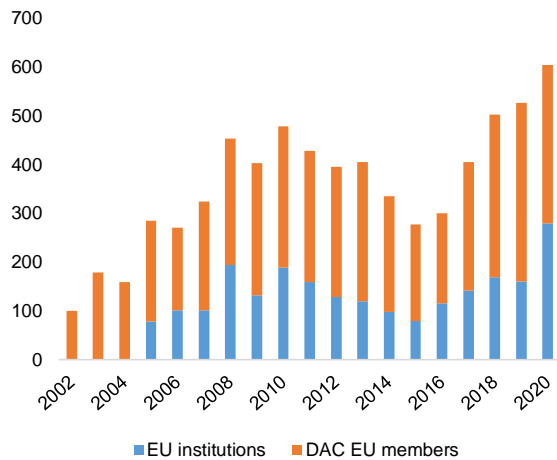
Source: Based on data from the Export Promotion Bureau (EPB) of Bangladesh.

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



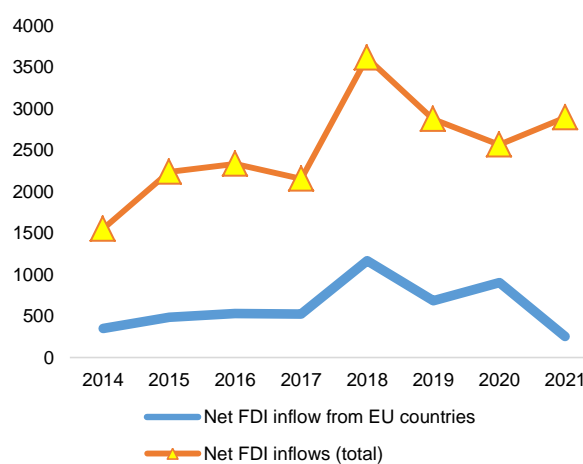
Source: Based on data from the Export Promotion Bureau (EPB) of Bangladesh.

**Figure 3: EU ODA disbursement to Bangladesh (million \$)**



Source: OECDstat data.

**Figure 4: Net FDI inflows into Bangladesh (million \$)**



Source: Bangladesh Bank data.

## **Emerging challenges affecting Bangladesh-EU trade and economic relations**

Bangladesh still has huge export potential in the EU as it is estimated that only 60 per cent of export potential is currently utilised. However, the nature of trade relations with the EU, or, more precisely, Bangladesh's dependence on EU trade preference, is now set to come to terms with other major developments that will require a profound transformation of the current trade and cooperation regime. This is because of several reasons as outlined below.

### **LDC graduation**

First and foremost, LDC graduation means the unilateral trade preferential regimes offered by many trade partners, including the EU, will change. Bangladesh's graduation in 2026 will result in immediate cessation of LDC-related trade preferences in most countries including Canada, China, India, and Japan. Only the EU (and the UK) would provide an additional three-year transition period and thus EBA trade preferences will come to an end in 2029. After graduation, a country can apply for some duty-free market access under the EU GSP+ programme. However, the new GSP regime for 2024-34, as proposed by the EU and currently under consideration by its parliament would result in discontinuation of any benefits for Bangladesh's clothing items due to safeguard measures mentioned in Article 29 of the proposed EU GSP. Accessing GSP+ benefits for other products depends on complying with 32 pre-specified international conventions. 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 effective implementations of all these conventions. Therefore, within the next few years, Bangladesh could see its market access terms in the EU changing quite remarkably.

### **Other countries' trade agreements with the EU**

While Bangladesh stands to lose trade preferences, free trade agreements (FTAs) could allow its competitors to gain competitive advantages in the EU. For instance, Vietnam-- already a major apparel exporter--has secured with the EU an FTA, which came into effect in August 2020. To put things in perspective, Vietnam will see tariffs on its clothing exports to the EU gradually decline from an average of 9 per cent to zero around almost the same time as Bangladesh's duty-free access coming to an end and being replaced with an average tariff of around 12 per cent. Even countries like Pakistan and Sri Lanka have access to GSP+ while Indonesia, which is another major apparel-supplying country, is currently negotiating an FTA with the European Union.

**The EU Green Deal and its carbon border adjustment mechanism (CBAM)** The recently proposed EU Green Deal aims to make use of a carbon border adjustment mechanism (CBAM) to internalise the cost of CO<sub>2</sub> in both domestically produced and imported goods. Under the CBAM, the EU wants to price the embedded carbon content in imports which will be equivalent to the price of CO<sub>2</sub> faced by domestic firms under its Emission Trading System (ETS). The European Parliament and European Council have reached a provisional agreement on the terms of the CBAM. According to the deal, it will initially cover mainly iron and steel, cement, aluminium, fertilisers and electricity. The CBAM will enter into force in its transitional phase from 1 October 2023. During 2023-2025, a simplified system, requiring importers to report the emissions embedded in relevant imports. From 2026 onwards, EU importers would start paying a financial

adjustment by surrendering the amount of CBAM certificates that correspond to the emissions embedded in their imports. The price of the certificates will be calculated depending on the weekly average auction price of EU ETS allowances expressed in €/tonne of CO<sub>2</sub> emitted. The phasing-out of free allocation under the EU ETS will take place in parallel with the phasing-in of CBAM in the period 2026-2034. Additional sectors are likely to be brought under coverage later. This implies that whether goods are produced in an environmental-friendly manner could soon be a major factor in export competitiveness.

### **Environmental, Social and Governance (ESG) compliance**

The emerging trends in global trade and investment regimes, led by the EU, seem to suggest that the future success of exports will critically hinge upon ESG compliance. While the readymade garment sector of Bangladesh is already under scrutiny to some extent, such standards for other sectors are also equally important and could determine future market access into the EU. The EU's Directive on Corporate Sustainability Due Diligence and supply chain laws of individual member states may affect businesses in the developing countries, including Bangladesh, that supply to the EU. Companies will have to monitor and undertake the required due diligence exercise to be able to export to the EU.

### **Way forward**

The above factors call for immediate policy attention to assess the major trends and emerging issues affecting the future of trade prospects with the EU. While LDC graduation has received prominence in policy discourse, Bangladesh seems to remain focused on the existing unilateral LDC-style trade preferences.

Many Bangladeshi stakeholder representatives are also highlighting the need for securing a trade deal (i.e. FTA) with the EU. It is often argued that other trade partners will find Bangladesh as an important partner to strike an FTA given its sustained economic growth performance, making it one of the largest 30 major economies. However, Bangladesh lacks a credible track record for undertaking and sustaining major policy reforms in such areas as trade, industrial policy, investment, intellectual property and environmental protection that are now considered most essential for negotiating a trade agreement with any major economy and regional groups in the world. It is also not adequately appreciated that clinching a good trade deal takes a long preparatory phase and the actual negotiation itself often takes 7-10 years.

- Moving forward, Bangladesh needs to develop a long-term strategy and action plan for a transformed and strengthened Bangladesh-EU cooperation regime.
- Bangladesh must effectively engage with the EU to secure favourable market access terms in the post-LDC graduation period. Especially, the market access conditions for readymade garments would be an important issues.
- Securing a full-fledged free trade and investment agreement with the EU for maintaining the current market access for exports and attracting investment should also constitute a possible option.
- A trade deal or future preferences in the EU would, however, require Bangladesh taking time-bound actions for ensuring conformity with international conventions/standards and to make improvements in various other

related areas such as environment, investment, intellectual property, etc.

- Since the Carbon Border Adjustment Mechanism is going to be the feature of trading with the EU, Bangladesh should prepare and consider its options for protecting export competitiveness, including establishing a domestic carbon market, and formulating and implementing carbon reduction policies.
- It is likely that following the EU CBAM, other major trading partners adopt similar schemes. Therefore, Bangladesh must prepare well and take the necessary initiatives now to remain competitive.
- Sustainable production practices of the exporting firms and the adoption of ESG-related compliances are going to be important determinants for export success.

Implementing Environmental and Social Governance should be a key priority for Bangladesh.

- The cost of doing business is considered excessively high in Bangladesh because of such factors as infrastructural bottlenecks, inefficient customs processes, incompetent port management and trade facilitation measures, dysfunctional inland transportation, and weak governance. Tackling the high cost of doing business and investing in connectivity and trade facilitation measures will be important to boost competitiveness.
- Bangladesh should seek additional EU assistance and make use of the available technical and financial assistance in helping shape a transformed trade and economic partnership with the EU for the coming decades.

This policy brief is an outgrowth of a RAPID research project supported by Friedrich-Ebert-Stiftung Bangladesh (FES). It has been prepared by Mohammad A. Razzaque (Chairman, RAPID) and Jillur Rahman (Assistant Professor, Department of Economics, Jagannath University and Associate Director, RAPID). Any imitations and/or views expressed in this paper are those of the authors and should not be attributed to Friedrich-Ebert-Stiftung Bangladesh (FES).