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Australian Government
Department of Foreign Affairs and Trade

POLICY BRIEF

September 2025

Strategic Approaches to FTAs in the Context of LDC Graduation: Policy Imperatives for Bangladesh

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Abstract: The impending graduation from its LDC status marks a critical transition for Bangladesh as the resultant loss of preferential market access threatens to undermine its export competitiveness. This paper analyses the strategic importance of Free Trade Agreements (FTAs) in mitigating these risks and outlines a framework to guide Bangladesh's engagement in reciprocity-based trade arrangements. It identifies priority markets where FTAs or alternative arrangements are essential to retain duty-free market access and also to maintain parity with rivals. Key challenges confronted by Bangladesh in pursuing FTAs include revenue dependence on high tariffs, which raises the risk of fiscal losses and trade diversion in the face of any tariff reduction as part of FTA negotiations; weak compliance with international standards that reduces credibility with partners and limits product diversification; a narrow export basket, which constrains the scope of offensive interests in negotiations; entrenched vested interests that resist liberalisation and reform; limited trade complementarity, which weakens the economic case for deals with many partners; and inadequate institutional capacity for negotiation, which hampers the ability to prepare and defend credible positions. The paper recommends a sequenced reform strategy centred on rationalising tariffs, prioritising FTA negotiations in markets where preference erosion is most acute, leveraging WTO flexibilities for potential South–South agreements (for instance, with China and India), strengthening institutional capacity through a permanent institutional framework for systematic trade negotiations, and building domestic support for gradual liberalisation.

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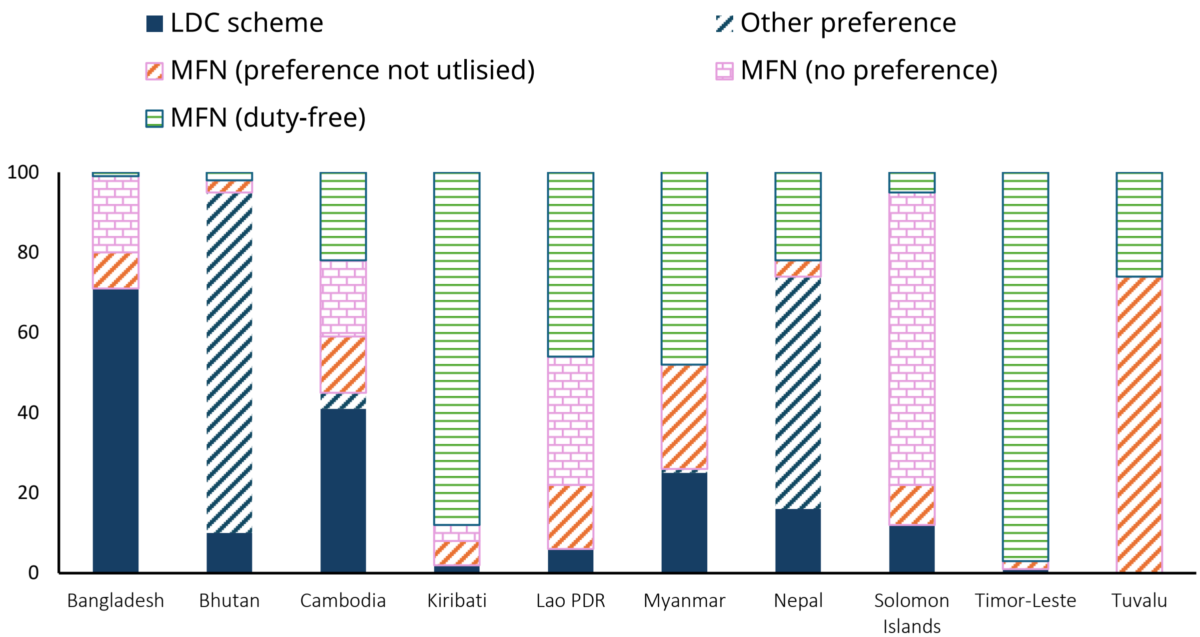
I. Introduction: Need for A Strategic Framework for FTAs

Bangladesh's forthcoming graduation from LDC status in November 2026 poses significant risks to its export competitiveness, particularly due to the anticipated loss of trade preferences currently enjoyed in several key markets. Given that over 80 per cent of exports are concentrated in apparel products that usually have much higher tariff rates in most importing countries in comparison with the most favoured nation (MFN) average rate for manufacturing, the impact could be disproportionately severe. Retaining preferential access through reciprocal Free Trade Agreements (FTAs) has thus become critical. Despite Bangladesh's strong economic growth record and large protected market making it an attractive FTA partner, its historical reliance on unilateral preferences and protectionist trade policy has constrained its readiness for FTA-based trading arrangements. Furthermore, despite numerous MoUs and feasibility studies. Bangladesh remains largely outside bilateral and regional trade arrangements apart from the currently dysfunctional SAFTA. The paper sets out to examine these structural and institutional impediments and proposes a strategic framework to guide Bangladesh's FTA engagement in the context of LDC graduation.

II. Significance of FTAs for Bangladesh

Bangladesh stands out for its heavy reliance on LDC-specific trade preferences as nearly three-quarters of its exports enjoy duty-free access under these arrangements (Figure 1). In critical markets such as Australia, the European Union, and the United Kingdom, the figure climbs even higher, exceeding 90 per cent. This level of dependence is far greater than that of other LDCs, many of which export primary commodities that face little or no tariffs to begin with, or benefit from bilateral trade deals that offer duty-free access regardless of LDC status. As Bangladesh prepares to graduate from the LDC group in 2026, this extensive exposure leaves its export sector, especially the apparel industry, facing steep tariff increases, with average Most Favoured Nation (MFN) rates ranging from 9 to 20 per cent across key markets. Although Australia has pledged to maintain existing preferences, most other partners including the EU, Canada, India, Japan, Korea, and China will either raise tariffs or apply more restrictive conditions, such as the UK's double transformation requirement for garments under its Enhanced Preferences scheme. What makes the situation even more pressing is that Bangladesh's competitors are moving quickly to secure trade advantages through bilateral deals. Viet Nam and India, for example, have signed or are negotiating FTAs with major importers like the EU, UK, and Canada, effectively gaining tariff-free access just as Bangladesh risks losing it. Under the EU–Viet Nam FTA, tariffs on Viet Nam's apparel exports are being phased out, coinciding with the end of Bangladesh's transition period, when its own exports will start facing nearly 12 per cent tariffs. Bangladesh has already seen a tangible impact: it was once the second-largest apparel exporter to Canada but has now been overtaken by Viet Nam, following the latter's accession to the CPTPP. These developments highlight a critical reality: unless Bangladesh proactively negotiates reciprocal FTAs, it risks falling behind in global export markets, precisely at a time when preserving competitiveness is more urgent than ever.

Figure 1: Breakdown of selected LDC exports by duty type (%)



Source: Estimation based on the WTO Preferential Trade Arrangement (PTA) database. Note: The chart shows the share of exports from some selected LDCs and one recently graduated LDC (Bhutan) by types of tariff treatment they receive in importing countries. LDC Scheme refers to unilateral tariff preferences granted to LDCs by developed and developing countries under their respective GSP arrangements. These schemes provide duty-free or reduced-duty market access specifically for LDCs. MFN (duty-free) means products facing zero MFN tariffs by default. MFN (no preference) means the products that do not receive any preference and are subject to standard MFN tariffs. MFN (preference not utilised) represents tariff preferences that are available but not used by the exporting country, possibly due to not fulfilling rules of origin requirements. Other preferences include non-LDC bilateral or regional preferential trade arrangements, such as regional trade agreements (RTAs) and bilateral FTAs under which exporting countries get preferential access.

III. Targeted Approach to FTA Engagement

Given its limited institutional capacity and protectionist legacy, Bangladesh must take a carefully targeted approach when considering future FTAs. Not all trade agreements deliver benefits, and their outcomes depend heavily on the economic structures, existing trade patterns, and compatibility between partner countries. While FTAs can improve market access, they can also lead to trade diversion and revenue losses—especially for countries like Bangladesh with high tariffs and a narrow export base.

Understanding complementary trade specialisation: Theoretical insights and empirical analyses suggest that FTAs with developed countries often produce clearer gains for developing partners, especially when trade specialisation is complementary. In contrast, South–South FTAs, particularly those involving countries with overlapping production structures and weak trade complementarity, tend to yield modest benefits for weaker partners unless designed with sufficient flexibility and asymmetry.

Using ex-ante assessment tools with caution: Ex-ante assessment tools like projections using trade complementarity indices and economic models can help guide FTA prioritisation, but they have limitations. Bangladesh's low trade complementarity scores with most major economies reflect its over-reliance on apparel exports and misalignment with the import profiles of key partners. Furthermore, models often fail to capture the complexity of real-world negotiations, such as rules of origin, sensitive product exclusions, and non-tariff barriers. Despite these challenges, well-negotiated FTAs can help anchor domestic reforms, attract investment, and facilitate greater integration into global value chains—benefits that go far beyond immediate tariff reductions.

Safeguarding market access in key export destinations: In light of LDC graduation, Bangladesh’s most urgent task is to safeguard its access to key export destinations. The EU remains a top priority, with options including GSP+ or a bilateral FTA if current preferences cannot be maintained. FTAs with the USA, where Bangladesh faces the highest tariffs, could offer significant gains, especially as reciprocal tariff threats loom. Canada and Japan may also warrant FTA negotiations post-graduation, particularly to maintain parity with competitors like Viet Nam, which already enjoys duty-free access in these markets.

Strategic engagement with India and China: While India and China are not major export destinations, they are Bangladesh’s top import sources and regional powerhouses. FTAs with these partners carry risks of import surges, but they also present long-term opportunities for investment, regional integration, and value chain participation—provided negotiations are strategically framed and designed with safeguards under WTO provisions.

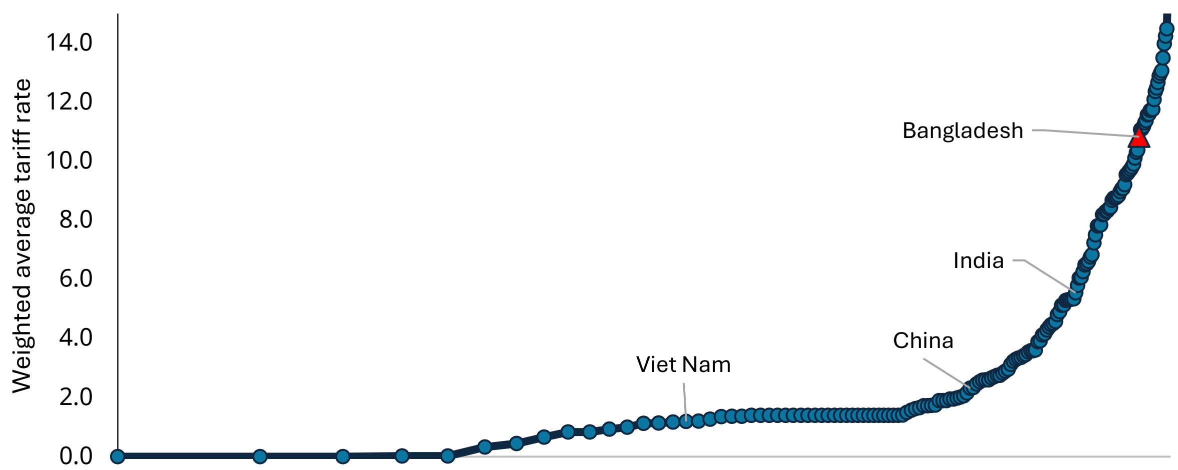
Accession to the Regional Comprehensive Economic Partnership (RCEP): Finally, joining the Regional Comprehensive Economic Partnership (RCEP) could offer Bangladesh a broader and more dynamic route to trade integration. Beyond immediate market access, RCEP’s harmonised standards, large market scale, and phased liberalisation timeline could support Bangladesh’s aspirations for export diversification and industrial upgrading, while easing the burden of negotiating multiple bilateral FTAs.

IV. Key Challenges in Pursuing FTAs

Bangladesh faces a complex set of structural and policy-related constraints that limit its ability to effectively engage in free trade agreements. These challenges are deeply interconnected and cannot be understood in isolation.

Protectionist trade regime and revenue dependence: At the heart of the problem is a highly protectionist trade regime. With average tariffs—especially when para-tariffs are included—among the highest in the world, Bangladesh's trade structure creates serious risks of revenue loss and trade diversion if reciprocal agreements are pursued without prior reform (Figure 2). This is particularly worrying given the country’s heavy reliance on trade taxes, which account for more than a quarter of total government revenue. Without a robust strategy for domestic revenue mobilisation, tariff liberalisation remains fiscally difficult.

Figure 2: Weighted mean tariff rates across countries



Source: World Bank's World Development Indicators (WDI).

Weak compliance with international standards: Another concern is the limited quality compliance in domestic manufacturing. Without pressure to meet international standards, many firms remain focused on the local market, and even export-ready sectors like leather have lost global buyers due to poor environmental compliance. This lack of alignment with international benchmarks further discourages outward orientation and export diversification.

Narrow export base and limited trade complementarity: Bangladesh's narrow export base compounds these problems. With exports largely concentrated in a few products, mostly apparel, the country finds it difficult to negotiate broad-based trade agreements. It lacks the product diversity needed to pursue an offensive trade strategy or to offer reciprocal concessions across sectors. This also weakens trade complementarity with potential partners, making the economic case for many FTAs relatively weak.

Resistance from vested interests: Resistance from vested interests further hinders progress. Powerful domestic groups that benefit from high tariffs and protectionist policies are often hostile to liberalisation. This resistance shapes government policy and contributes to ongoing inconsistencies between national strategies and actual implementation. While the Smooth Transition Strategy and the National Tariff Policy call for modernising trade policy, the reality on the ground remains driven by protectionist impulses, as illustrated by recent bans and ad hoc policy reversals.

Limited Attractiveness to Potential Partners: Adding to these domestic challenges is the lack of interest from many prospective partner countries. Developed economies are increasingly looking for deeper, more comprehensive trade deals that cover not just tariffs, but also labour standards, environmental protections, investment rules, and public procurement. Bangladesh's limited institutional readiness and regulatory capacity—owing in part to its historical LDC status—make it a less attractive FTA partner. The country's modest levels of foreign direct investment also signal weak global business linkages.

Finally, the lack of trade negotiation capacity is a fundamental constraint. Having long relied on non-reciprocal trade preferences, Bangladesh has not developed the institutional expertise or inter-ministerial coordination required for complex modern trade negotiations. Key agencies often operate in silos, and there is a lack of rigorous preparatory work on sectoral sensitivities or export potential. Without a coordinated, government-wide strategy backed by legal, technical, and sectoral insights, formulating and defending credible negotiating positions remains a serious challenge.

V. Strategic Approaches to Navigating FTA Challenges: Policy Imperatives

To navigate the complex challenges of entering into Free Trade Agreements, Bangladesh needs a well-calibrated strategy that balances short-term policy imperatives with long-term development goals.

Rationalising the tariff Structure: Central to this is the urgent need to rationalise its high tariff structure, which continues to distort incentives, discourages export diversification, and raises the risk of trade diversion in reciprocal trade deals. The National Tariff Policy and the Smooth Transition Strategy (STS) both call for lowering tariffs, reducing anti-export bias, and aligning trade incentives more closely with the country's development objectives. Successful implementation of these reforms, supported by strengthened domestic resource mobilisation, would not only mitigate revenue concerns but also unlock broader gains for the economy, including increased investment and export growth.

Strategic prioritisation in trade negotiations: Alongside tariff reform, Bangladesh must adopt a more strategic and focused approach to negotiating trade agreements. Rather than pursuing numerous memoranda of understanding and feasibility studies with limited follow-up, efforts should prioritise countries and blocs where preferences are at risk due to LDC graduation or where clear opportunities exist to boost exports. Key priorities include maintaining duty-free access to the EU, finalising a comprehensive agreement with Japan, and initiating deeper engagement with the United States, despite the complexity of its trade policy environment. Accession to the Regional Comprehensive Economic Partnership (RCEP) also offers substantial medium- to long-term benefits, including integration into dynamic regional value chains and improved investment prospects.

Managing FTAs with India and China: India and China are Bangladesh's two most important import sources and increasingly relevant export destinations. While neither currently accounts for a large share of Bangladesh's total exports, both offer significant potential for future market expansion, especially in non-apparel sectors. However, any prospective FTA with these countries must be approached with caution. Given their vast supply-side capacities, entering into reciprocal agreements without adequate safeguards could expose Bangladesh to sudden import surges and undermine domestic industries.

Leveraging WTO flexibilities for South–South FTAs: That said, there are flexibilities available—particularly under the WTO's *Enabling Clause*, which governs South–South preferential trade agreements. Unlike North–South FTAs that must comply with the strict requirements of GATT Article XXIV (such as liberalising "substantially all trade"), the Enabling Clause allows developing countries to enter into trade agreements with less-than-full reciprocity, phased tariff reductions, and exemptions for sensitive products. This means Bangladesh can design agreements that liberalise only selected sectors aligned with its comparative advantage, while protecting others through exclusion lists, longer implementation timelines, and safeguard mechanisms. These provisions have been used in other South–South FTAs to ensure that weaker economies are not overwhelmed by more competitive partners.

Moreover, special and differential treatment (S&DT) provisions may also be invoked, allowing for asymmetrical commitments where Bangladesh can request extended transition periods, flexible rules of origin, and technical assistance to meet compliance and regulatory requirements. By leveraging these flexibilities, Bangladesh can pursue engagement with India and China in a way that supports domestic industrial upgrading, enables gradual adjustment, and avoids one-sided liberalisation that might otherwise lead to welfare losses or structural dislocation.

Strengthening institutional capacity for trade negotiations: Institutional capacity is another area where reform is essential. Bangladesh's limited experience with reciprocal trade negotiations has left it without a dedicated cadre of trade negotiators or an institutional framework to manage complex, multidisciplinary trade agreements. Establishing a permanent pool of trained negotiators—drawing from government, think tanks, and relevant agencies—and creating a Chief Trade Negotiator's Office would provide the leadership, coherence, and technical depth needed to support future FTA efforts. Complementing this with sustained training and strategy development would help shift from reactive trade engagements to more proactive and technically sound negotiation processes.

Building domestic support for liberalisation: Lastly, building broad-based domestic support for trade liberalisation is vital. Instead of abrupt policy shifts, the government should pursue gradual, transparent reforms that replace blanket protection with targeted, time-bound support for firms to become competitive. This approach, as laid out in the STS, includes improving quality standards, aligning production with global demand, and promoting export diversification. By signalling a credible path to liberalisation while protecting vulnerable sectors during the transition, Bangladesh can create the political and institutional conditions necessary to support a more open and competitive economy in the post-LDC era.

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