Bangladesh's Graduation from the Group of LDCs: Issues for the Private Sector

Executive Summary

Background

Defying overwhelming odds, Bangladesh has continued to demonstrate impressive socio-economic progress. The impending graduation from least developed country (LDC) status is a global acknowledgment of the country's major developmental transition. A vibrant and well-developed private sector has played a key role in the country's rapid economic transformation. Along with export success in readymade garments, buoyant manufacturing activities have characterized the development process. The private sector accounts for three-quarters of all investment activities and the share of private investment in GDP is estimated at around 23 per cent.

It is however inevitable that the development transition will imply certain privileges and special and differential treatments that are exclusively available to LDCs will have to be forgone. The impending graduation is thus likely to have certain implications for the private sector, as it gives rise to concerns about potentially sizeable economic costs due to the loss of access to various support measures associated with the LDC status.

Preference erosion in the international trade regime

Amongst the LDCs, Bangladesh has been the largest beneficiary of LDC-specific non-reciprocal trade preferences. Currently, almost three-quarters of the country's exports enjoy duty-free market access. Bangladesh's largest export market is the EU where virtually all LDC exports are duty-free under the EU's Everything But Arms (EBA) scheme for LDCs. Amongst others, Australia, Canada, China, India, Japan, and the Republic of Korea are important markets with LDC preferential access.

Given its huge importance, loss of preferential access in the EU could be a major issue for Bangladesh. The EU, however, does provide an additional three-year transition period, which means the current market access conditions are likely to remain unchanged until 2027. After graduation, an LDC can either be entitled to EU preferential access under its GSP Plus (GSP+) or Standard GSP schemes. Under the current provisions, while GSP+ would allow duty-free readymade garment exports under a more stringent rule of origin conditions, Standard GSP would provide some duty concessions only with average tariff rate on clothing items being 9.6 per cent. Given the existing EU GSP admission criteria, it appears that Bangladesh would not qualify for GSP+ and while clothing items could face product graduation under Standard GSP thereby not getting duty-free access. A new EU GSP regime will come into operation from 2023 replacing the current system. Therefore, there is an opportunity for Bangladesh to engage with the EU and influence the terms and conditions of the upcoming GSP regime.

Post-graduation market access in other countries (such as Australia, Canada, China, India Japan, Norway and the Republic of Korea) will also see more stringent rules of origin criteria and smaller and/or no margins of preference. China currently provides Bangladesh duty-free access in 61 per cent of tariff lines while many LDCs are enjoying the same coverage for at least 95 per cent of products. In China, there is no provision of preferential access for graduating LDCs or developing countries. With more than $1.25 billion in exports in FY19, India has recently emerged as a key export destination for local exporters. In India, Bangladesh enjoys duty-free and quota-free market access (with the exception of 25 products) through SAFTA's LDC- specific preferential provisions. This will also be significantly curtailed after LDC graduation.

Loss of policy space

LDC graduation could also mean a substantial loss of policy space in supporting the private sector. Given supply-side constraints, LDCs are often exempt from making commitments and implementing most demanding and stringent provisions of trade agreements. WTO members are also generally reluctant about raising concerns or lodging official complaints about individual LDCs' policy support measures that would otherwise deem inconsistent or non-compliant with international trade rules and regulations. As an LDC, Bangladesh has made significant use of such policy space in supporting the private sectors.

In terms of reduced policy space, providing the export sector with direct support in the form of cash assistance and subsidies could become a major issue after LDC-graduation. The relevant multilateral trade rules, which are directed through the WTO's Agreement on Subsidies and Countervailing Measures and Agreement on Agriculture, prohibits direct export subsidies.

Post-graduation Bangladesh will require ensuring firmer protections of intellectual property rights (IPR). Until now, the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) has allowed Bangladesh to enjoy relaxed IPR provisions and special waiver for the Pharmaceutical sector including the option to completely disregard international patents. After graduation, certain provisions in the import regime for pharmaceutical products may have to undergo changes for ensuring their being consistent with WTO rules and regulations.

Development financing

Overseas development assistance (ODA) has been an important source of development financing, which has supported private sector growth through investments in physical and social infrastructures. LDC graduation is unlikely to have any significant implications for the availability of such assistance. Although not related to LDC graduation, Bangladesh is already subject to higher interest rates on concessional loans, due to the transition from low-income to lower-middle-income countries. Bangladesh has the opportunity of enhancing its domestic resource mobilisation efforts, which can help in continuing with infrastructural development and maintaining a sustainable dependence on foreign assistance.

Way forward for smooth graduation and tackling post-graduation challenges

A successful LDC graduation by 2024 will be a monumental accomplishment for Bangladesh. But there is, however, no denying that the development transition will also bring some challenges. Economic development is about building resilience and generating capacities to deal with unfolding circumstances that may not always remain favourable. Therefore, the task is now to prepare well for being able to tackle any challenges to ensure smooth graduation, while helping business enterprises protect and promote their competitiveness. In this respect, adaptation strategies should consider various policy options at the national level and changes or improvements in firm-level business and operational practices. Few such broad areas of interventions are listed below.

- The first and foremost policy focus should be on proactively exploring trade preferences beyond graduation. There are various opportunities for mitigating any likely adverse consequences resulting from loss of unilateral trade preferences in the largest export market of the EU. A new EU–GSP regime will come into operation in 2023 for which there will be in-depth consultations. Bangladesh should proactively engage in the process to seek for relaxed admission criteria for GSP+ including any favourable changes in the rules of origin provisions as well. With other important preference-providing countries (such as Australia, Canada, Japan, the Republic of Korea, etc.) as well, there should be proactive engagements in securing an extended transition period and considering future arrangements, including bilateral trade deals.

  In China, Bangladesh should try to obtain an immediate expanded coverage of duty-free access from the current preference of around 61 per cent of tariff lines to at least 95 per cent, which many other LDCs are enjoying. With India, the key focus should be on securing a full tariff concession either under improved non-LDC SAFTA provisions or a bilateral trading arrangement. Given the precedence of the Maldives' continued receiving the same level of access in India after the former's LDC graduation in 2011, Bangladesh can request the same preference. Along with asking for an extended graduation transition period, a gradual withdrawal of tariff preferences and negotiating a bilateral FTA should be among considerations as part of building a deepened trade and economic cooperation arrangements with China and India.

- In providing support to exporters, WTO-consistent provisions should be developed under a medium to long-term export policy. Since direct subsidies and/or cash assistance linked to certain sectors and export-performance will be extremely difficult to continue with innovative options and appropriate restructuring of the export policy must be considered. Although not all non-LDC developing country has WTO-consistent support measures, Bangladesh, nevertheless, can draw lessons from the existing practices in developing suitable support mechanisms

  Delinking the subsidies and/or direct support from any sectors and/or export performance is the most critical challenge in developing a WTO-consistent export support regime. Even when it is possible to develop such policies, their implementation could substantially be more complex than the currently administered cash assistance scheme. it seems that providing support for market promotion, R&D, retailing activities in foreign markets will remain consistent with multilateral trade rules. Such incentives may also help exporters move up the value chain and global competitiveness.

- Domestic revenue mobilisation has important implications for development financing in the post-LDC era. A reinvigorated approach to domestic resource mobilisaiton should also aim to reduce the dependence on import revenues. Currently, more than 32 per cent of all government revenues are sourced from import duties and other taxes.[1] It is generally recognized that Less-than-optimal revenue collection from domestic sources is keeping Bangladesh reliant upon revenues gathered from imports. This excessive dependence on trade revenues will make it difficult to undertake reciprocity-based bilateral and regional trade deals.

  The dependence on import tariffs – often very high when other para tariffs such as supplementary and regulatory duties are added – has other implications as well. A high import tax incidence increases profitability in the domestic market. This also reduces exporting incentives in relative terms. Sustained economic growth with a large population means, the domestic market for investors has become very attractive, which is further exacerbated by high import tariffs. In contrast, trade preferences are increasingly coming under pressure.[2] Therefore, a future export support policy will have to carefully evaluate the implications of high import tariffs on many export-oriented industries and prominent export items.

---

[1] Import tariffs alone account for 11 per cent of government revenues. When supplementary duties, regulatory duties, and VAT on imports are consider, the contribution of import taxes and duties to government revenues becomes approximately 32 per cent.

[2] This is due to LDC graduation-led loss of trade preferences as well as likely discontinuation of export subsidies. Furthermore, Bangladesh's exchange rate is thought to have become significantly overvalued compared to many other partner countries, thereby triggering competitiveness pressure.

- A post-graduation trade strategy must consider effective ways of promoting firm-level competitiveness. This involves, amongst others, raising labour productivity, technological up-gradation, moving up the value chains and attracting foreign direct investment. Bangladesh has ample opportunities for investing in state-of-the-art technologies and skill development for which public-private partnerships will be important. Particularly, enterprises will need support to procure appropriate technologies and to have access to skilled workforce. FDI in this regard can greatly help as foreign firms are known for their use of improved technologies, sound management practices, and effective integration within global value chains (GVCs). A final stage in improving firm-level competitiveness is to develop capacities to move upwards in GVCs. This requires firms’ involvement in branding, marketing, retailing, and R&D activities. Since LDC-graduation is still a few years away, Bangladesh needs to aim for enhancing firm-level capacity building for improving future competitiveness.

- The pharmaceutical sector inextricably linked to public health for which market mechanisms may not always ensure optimal outcomes. Thus, the government has obligations to ensure the rights to affordable healthcare. Maintaining a balance between the interest of domestic producers, consumers, and rights-holding multinational firms will be essential from the perspective of regulatory bodies after LDC graduation. To ensure consistency with WTO regulations, Bangladesh will have to review the legal provisions and frameworks related to the pharmaceutical industry, including patent timelines, import conditions, investment regulations on multinationals, etc. Direct export incentives such as cash assistance may not be available as a policy instrument for supporting exporters. In addition, to ensure smooth graduation and to avoid abrupt policy discontinuity, Bangladesh should pursue its case to avail the full duration of the TRIPS-Pharmaceutical waiver period until 1 January 2033.

- Effective tackling of Infrastructural bottlenecks and reducing the cost of doing business should help improve export competitiveness. The progress made in World Bank’s Doing Business Index 2020 is quite encouraging for that matter Bangladesh needs to continue with its relentless efforts in making further progress.

Addressing infrastructural and business costs can substantially help recoup a part of trade preferences that will be lost after graduation. In this respect, the Ministry of Commerce, Export Promotion Bureau, National Board of Revenue, Bangladesh Bank, Bangladesh Investment Development Authority (BIDA) and other relevant agencies in collaboration with the private sector should develop a joint action plan to tackle the problems associated with trade logistics and other bottlenecks. Addressing these challenges could provide the biggest boost to external competitiveness.