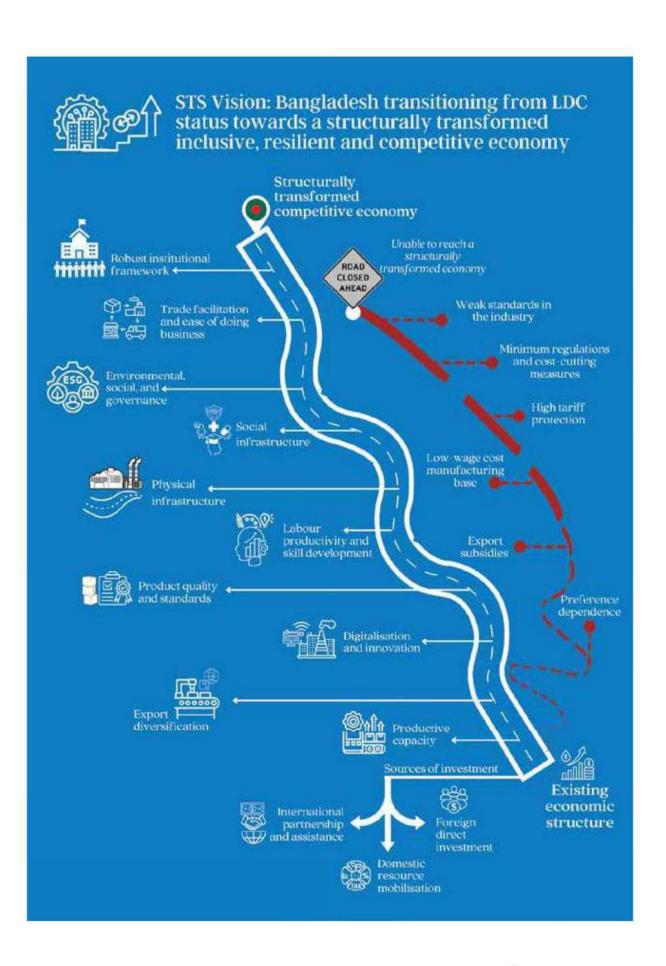
Chapter III

Smooth Transition Strategy Vision: Bangladesh Transitioning from LDC Status towards a Structurally Transformed Inclusive, Resilient and Competitive Economy



3.1 Embarking on a new phase of structural transformation

Bangladesh has undergone an initial phase of structural shift, with its manufacturing exports rising to dominate the export basket along with the growing relative significance of industrial outputs in the overall economy. While the RMG-led export expansion has contributed significantly to both these trends, the share of exports in GDP has fallen significantly over the past decade to exhibit a thriving import-competing sector.⁵¹ Double-digit growth in manufacturing has been more than just a garment story, with the domestic economy experiencing rapid growth in many sectors: from pharmaceuticals to furniture, ceramic to cement, footwear to fertiliser, handbags to handicrafts, plastic items to processed food, etc. Paradoxically, the growth of these sectors is not reflected in the ever-growing garment-concentrated export basket. This pattern of economic transformation has produced a dual production structure: an export-oriented garment sector, heavily reliant on trade preferences, drives export growth, while an import-competing sector, shielded by protective policies, primarily caters to domestic markets. The current economic model appears to have reached its limits, as the export sector remains relatively small in comparison to the rising demand for imported goods and services driven by the economy's significant expansion.

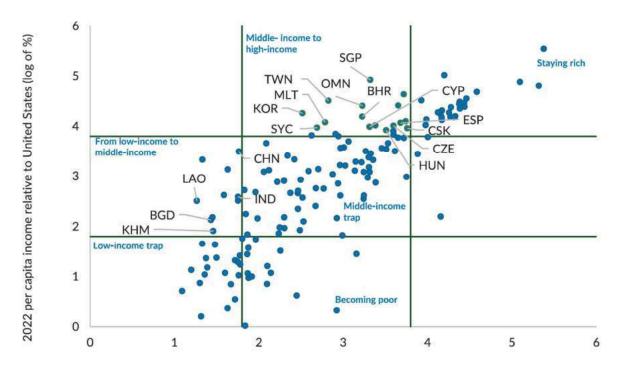
There is no denying that availability preferences alone did not ensure export success, as most other LDCs have not been able to capitalise on it. Therefore, developing the required supply side capacity, such as the large-scale garment manufacturing industry, has been a major achievement. However, it is important to recognise that Bangladesh's economic transformation has so far typically focussed on comparative advantage based on low wages, minimal regulations, and costcutting measures to achieve competitiveness. The next phase of structural transformation is required to consider what is known as high-road economic development, the salient features of which include, amongst others, enhancing productivity, creating decent or quality jobs, investing in skills development, fostering innovation and improving product standards, adopting sustainable business practices, and achieving inclusive growth. These features are now widely seen as important ingredients of comparative advantage rather than sheer wage-cost-based competitiveness. The high-road approach is particularly relevant for economies aiming to transition from dependence on low-value activities to more sophisticated, higher-value sectors. New sources of competitiveness based on product quality and innovation and improved compliance (comprising labour standards and environmental sustainability, amongst others) are crucial for establishing a country as a credible global supply chain participant.

As LDC graduation gives rise to concerns about losing access to various ISMs, it should be a trigger for high-road transformation and future readying the economy. It is worth pointing out that when Bangladesh becomes an upper-middle-income country, ISMs will disappear altogether. While residual unilateral trade preference may persist immediately post-LDC graduation, and efforts should be made to avail those, the focus must pivot towards deeper structural changes for developing and strengthening new sources of competitiveness. That is, the best way to deal with

⁵¹ The export-GDP ratio in Bangladesh has significantly declined over time, decreasing from 17.8 per cent in 2010-11 to 11.5 per cent in 2022-23 (Bangladesh Bank, 2024b; BBS, 2022).

LDC graduation is not to look for new support measures only but to push towards deep-seated structural transformation.

Figure 3.1: Country experience of moving out of low-income and middle-income traps



1970 per capita income relative to United States (log of %)

Source: Maddison Project Database 2023, accessed from

https://www.rug.nl/ggdc/historicaldevelopment/maddison/releases/maddison-project-database-2023.

Note: Per capita income is measured in terms of purchasing power parity. BGD - Bangladesh, BHR - Bahrain, CSK - Czechoslovakia, CYP - Cyprus, CZE - Czech Republic, ESP - Spain, HUN - Hungary, KHM - Cambodia, KOR - Republic of Korea, LAO - Lao People's DR, MLT - Malta, MMR - Myanmar, OMN - Oman, SGP - Singapore, SYC - Seychelles, TWN - Taiwan, Province of China. This chart is updated from the one provided by the World Bank (2013).

During a country's development journey, a potential challenge is avoiding the so-called Middle-Income Trap (GED, 2020c). Although standard growth theory predicts that low-income countries will grow at a faster rate and eventually converge with high-income countries, few have succeeded in achieving this, as reaching high-income status presents significant challenges and often involves a high risk of growth slowdowns along the way (Figure 3.1). One key finding that emerges from the cross-country growth experience is that traditional sources of economic growth—such as factor accumulation, low-wage labour, etc.—will have diminished, and thus, countries must find

drivers of productivity, innovation, and competitiveness while strengthening the economic fundamentals that foster and stabilise growth (Larson et al., 2016).⁵²

3.2 The state of current production and incentive structures

Bangladesh's production structure has evolved into a dichotomous state, characterised by distinct policy regimes for production aimed at exports and for the domestic market (OECD, 2023). This dual structure is a primary factor behind the lack of export diversification and the limited contribution of new products to export growth. The export-oriented sector prioritises securing duty-free raw materials and other incentives (such as cash assistance or export subsidies) alongside LDC-specific trade preferences to access international markets, whereas the import-competing sector remains protected by high customs duties and other para-tariff measures.

3.2.1 Global trade policy regime influencing the current incentive structure of Bangladesh

The global trade policy regime has been and continues to be instrumental in shaping and reinforcing Bangladesh's current export structure (Razzaque et al., 2024c). Historically, until 2005, global trade in textiles and clothing was governed by the Multi-Fiber Arrangement (MFA) quota system, which dispersed production within the sector and restricted exports from potentially competitive countries. The quota system incentivised international firms from newly industrialised economies to relocate production to countries like Bangladesh despite their limited domestic market presence, resulting in the emergence of "born to export" (BTE) firms that rapidly expanded their export activities (Astarloa et al., 2012). The labour-intensive nature of apparel production, coupled with abundant and trainable labour with low wages, was fostered by the quota system.

However, even after the dismantling of quota restrictions, high tariffs on apparel imports in major importing countries have persisted, with rates significantly higher than average tariffs for industrial goods. In contrast to the 2-6.5 per cent average tariffs on industrial goods in major OECD countries, apparel imports face significantly higher tariffs: 16.2 per cent in Canada, 11.5 per cent in the EU and UK, 12.5 per cent in the Republic of Korea, 9 per cent in Japan, and 10.6 per cent in the United States (Table 3.1).53 India, the largest buyer of Bangladeshi apparel items among

⁵² To mitigate the risk of falling into the middle-income trap, the World Development Report 2024 introduced the "3i strategy," which outlines a phased approach to economic development: Investment, Infusion, and Innovation (World Bank, 2024). According to this framework, successful middle-income countries must undergo two critical transitions to establish sustainable economic systems aligned with the principles of dynamic structural transformation. The first transition involves shifting from a "1i strategy," which focuses solely on accelerating investment, to a "2i strategy," which combines investment with technology infusion. In this phase, countries emphasise importing advanced technologies and integrating them effectively into domestic industries to enhance productivity and competitiveness. Following this transformation, the next phase is the "3i strategy," where the primary focus is on fostering innovation—while continuing to emphasise investment and infusion—as the central driver of economic growth. It is, however, important to note that while LDC graduation represents a pivotal opportunity for Bangladesh to realign its economic structure and policy framework in accordance with the 3i strategy, the middle-income trap issue should be of less concern at this stage. This is because the range of middle-income per capita income is quite large up to a GNI per capita of \$14,005, as per 2024-25 classification of countries by the World Bank, as against of Bangladesh's current GNI per capita of less than \$2,700. 53 Of these markets, Bangladesh does not receive any tariff preference in the U.S. It is still however the MFA quota system that initiated Bangladesh's apparel exports to the U.S.A. Lack of tariff preference means Bangladesh in 2022 held a modest share of 7 per cent in the U.S. apparel import, as against of a share of 22 per cent in the EU.

developing countries, also maintains tariffs well above the MFN average for the same sector. Consequently, Bangladesh benefits from a considerable competitive edge in apparel exports through LDC-specific duty-free preferences compared to many other sectors. Therefore, heavy specialisation in garment export was a rational response because tariff preference in it was much higher compared to exports from other suppliers without similar preferences, as well as compared to other sectors where MFN tariffs were much lower, resulting in small tariff preference margins.

Table 3.1: Tariffs on textiles and clothing vis-à-vis overall MFN tariffs in major importing countries of Bangladesh's apparel products

	Avg. MFN tariff on industrial sectors (ad valorem)	Avg. MFN tariff on apparel products (ad valorem)	Avg. tariff on textile (ad valorem)
Australia	2.6	4.5	4.2
Canada	2.0	16.2	6.2
China	6.4	6.7	7.1
EU	4.1	11.5	8.3
India	14.7	19.7	12.2
Japan	2.4	9.0	5.7
Korea, Rep. of	6.5	12.5	10.3
United Kingdom	2.9	11.5	7.0
United States	3.1	10.6	6.8

Source: Information obtained from the World Integrated Trade System (WITS) database (World Bank, n.d.).

Along with the international policy regime—motivated by the need to nurture a promising export sector-the export-oriented garment industry since the early 1990s has been boosted by a broad policy incentive system, which included measures such as the introduction of back-to-back letters of credit, bonded warehouse facilities, duty drawback schemes, and cash assistance (Rahman, 2014). Initially, these incentives predominantly favoured the garment sector, but significant changes occurred in the late 2000s, with cash assistance reduced for RMG exporters while remaining higher for non-RMG sectors.54

3.2.2. National trade policy regime

The lack of export response from non-garment sectors can be partly attributed to the high protection afforded by Bangladesh's trade policy framework to import-competing industries through customs duties and other import taxes such as supplementary and regulatory duties, often referred to as para-tariffs (Razzaque et al., 2024c). 55 When the nominal protection rate is measured

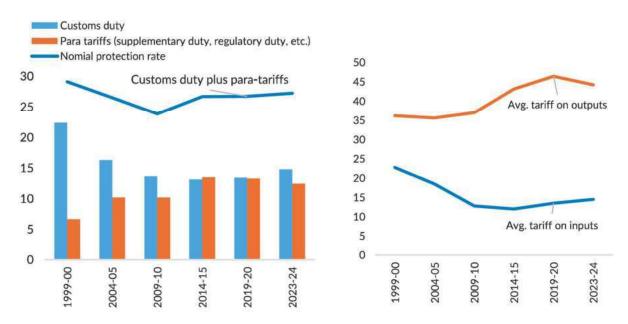
⁵⁴ Nevertheless, non-RMG exporters had to endure limited bonded warehouses facilities, and for them accessing other support measures, such as obtaining subsidised loans under the Export Development Fund (EDF), met with difficulties. Non-RMG sectors faced higher corporate tax rates until recently, when a uniform income tax rate for all exporters was introduced from 2022-23.

⁵⁵ While such taxes are supposed to be trade neutral, in reality, these are imposed mainly on imports. Originally intended to discourage the production and consumption of luxury items, supplementary duty primarily affects imports while leaving domestic production mostly untouched. Similarly, regulatory duty, initially introduced as a temporary solution for sudden import surges, has become a permanent fixture. Additionally, the implementation of VAT can also be protective

by import duties alone, the average MFN tariff for Bangladesh is estimated at 14.8 per cent, which is higher than that of individual East Asian countries, neighbouring countries such as Bhutan, Nepal, Pakistan, and Sri Lanka, but somewhat lower than that of India (18.1 per cent). However, when the para-tariffs are taken into consideration, the average nominal protection in Bangladesh is more than doubled to 28 per cent (Figure 3.2), making it much higher than any other country among global economies (World Bank, 2023). Along with this, due to tariff escalation, the difference between tariffs on inputs and outputs has widened over time, raising the effective rate of protection significantly, as shown in Figure 3.3 (ERD, 2024c; GED, 2020b).

Figure 3.2: Average customs duty, para tariffs, and nominal protection rate (%)

Figure 3.3: Average tariff on inputs and outputs (%)



Source: ERD (2024c)

The high level of protection has helped local industries, but it has come at the cost of hurting the export sector. Globally, firms typically commence exporting after establishing a strong domestic market presence, but this trend has been limited due to sustained protection. Tariffs raise prices and thus make the domestic market attractive to investors and producers relative to the global market, leading to a misallocation of resources that is detrimental to the growth and competitiveness of the export sector. As the level of tariff protection is so high, equivalent export support measures (e.g., subsidies) cannot be provided, resulting in what is known as anti-export bias (Table 3.2). In a developing country like Bangladesh, the role of trade and industrial policy in promoting domestic industries is crucial. However, prolonged high levels of protection over several decades appear to have hindered these industries from adequately preparing for the global market, as evidenced by their limited export response.

(Sattar, 2020) as imports are subjected to rigorous scrutiny whereas VAT enforcement for domestically produced goods often lacks effectiveness. This discrepancy further favours domestic production, creating an uneven playing field between imported and locally made goods.

When the effective exchange rate for imports (i.e., nominal exchange rate augmented by nominal rate of tariff protection) is compared with the effective exchange rate for exports (i.e., nominal exchange rate augmented by cash assistance and interest subsidy for exporters), the relative incentive for import-competing activities is found to be more than 30 per cent higher. It is crucial to acknowledge that a highly protective economy hinders its import-competing sectors from becoming competitive and innovative by disincentivising exports and shielding domestic industries from competition with more efficient international suppliers. In a developing country like Bangladesh, the role of trade and industrial policy in promoting domestic industries is crucial. However, prolonged high levels of protection over several decades appear to have hindered these industries from adequately preparing for the global market, as evidenced by their limited export response.

Table 3.2: Relative incentives for import-competing and export sectors

Fiscal Year	Average nominal protection (NPR) (%): Consumer goods	Nominal exchange rate (Tk/US\$)	Effective exchange rate for imports (EERm)	Effective exchange rate for exports (EERx)	Anti-Export Bias EERm/ EERx
2004-05	37.35	61.39	84.32	62.53	1.35
2005-06	38.80	67.08	93.11	68.06	1.37
2006-07	35.77	69.03	93.72	70.16	1.34
2007-08	34.19	68.60	92.05	70.02	1.31
2008-09	33.31	68.80	91.72	70.54	1.30
2009-10	41.20	69.18	97.68	71.39	1.37
2010-11	41.29	71.17	100.56	73.29	1.37
2011-12	48.36	79.10	117.35	81.47	1.44
2012-13	51.40	79.93	121.01	84.16	1.44
2013-14	50.67	77.72	117.10	82.76	1.41
2014-15	47.76	77.67	114.77	84.81	1.35
2015-16	45.95	78.26	114.22	84.55	1.35
2016-17	45.23	79.12	114.91	87.85	1.31
2017-18	45.98	82.10	119.85	90.22	1.33
2018-19	46.39	84.78	124.11	90.52	1.37
2019-20	46.43	84.78	124.14	91.69	1.35
2020-21	47	84.8	124.66	91.40	1.36
2021-22	43.62	86.3	123.94	92.48	1.34

Source: ERD (2024c).

The composition of the country's exports also reflects this trend. At the HS 6-digit level, Bangladesh's export basket contains about 1,400 non-readymade garments (non-RMG) export items, with about 84 per cent (1,165 products) being manufacturing items and the rest being agricultural goods.⁵⁶ Of these non-RMG products, only a quarter has export earnings of \$1 million each, while the others are quite small (Figure 3.4). Therefore, despite having some presence in the export basket, these products cannot expand their earnings from foreign markets. There are as many as 584 products (i.e., 42 per cent of all non-RMG products in the export basket) that are

⁵⁶ This analysis is based on the data for 2020-21.

found to be high to moderately competitive using the measure of revealed comparative advantage (RCA), as most widely used in assessing product competitiveness in international trade.⁵⁷ However, in all these products, the relative incentive for local sales is significantly higher (Table 3.3 & Table 3.4).

The average anti-export bias (AEB)—given that the ratio of average effective exchange for imports to the effective exchange rate for exports turns out to be higher than one—against the highly competitive export products of Bangladesh (e.g., jute goods, footwear, tableware, leather products like handbags) is estimated at 1.26. The corresponding policy-induced bias against the moderately and marginally competitive non-RMG goods are 1.195 and 1.153, respectively. In a bid to facilitate export diversification, various sectors have, from time to time, been identified as "highest priority" and "special development" sectors in export policies and "thrust sectors" in the Industrial Policy 2022 so that special policy attention towards their development can be provided. However, the relative incentives for the identified sectors remain unchanged as a strong anti-export bias seems to be associated with all non-RMG exports from the country.

Figure 3.4: Non-RMG export products

comparative disadvantage.

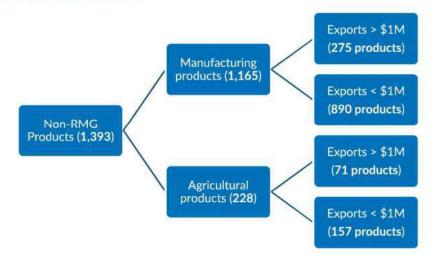


Table 3.3: Competitiveness of non-RMG products in Bangladesh's export basket

Competitiveness	Percentage of products in each category (%)				
	Agricultural products		Manufacturing products		
	Exports > \$1m	Exports < \$1m	Exports > \$1m	Exports < \$1m	
Highly competitive	28.17% (20)	1.91% (3)	42.18% (116)	3.93% (35)	
Moderately competitive	28.17% (20)	18.47% (29)	26.91% (74)	32.25% (287)	
Marginally competitive	43.66% (31)	79.62% (125)	30.91% (85)	63.82% (568)	

⁵⁷ Revealed comparative advantage (RCA) in international trade is a measure that indicates the relative advantage or disadvantage of a country in a particular product or service based on its export performance. It is calculated by comparing the share of a specific product in a country's total exports to the share of that product in global trade. If the RCA index is greater than 1, the country has a comparative advantage in that product; if it is less than 1, the country has a

Total	100.00% (71)	100.00% (157)	100.00% (275)	100.00% (890)
*Figures in the parenth	eses show the number of	products in each section		

Source: Estimates presented in ERD (2024c) based on EPB and UNCOMTRADE data.

Note: The degree of competitiveness, i.e., highly, moderately, and marginally competitive, is assessed by employing the so-called normalised RCA index. The NRCA index, to facilitate cross-country comparisons, measures the degree of deviation of a country's actual export from its comparative-advantage-neutral level in terms of its relative scale with respect to the world export market. To evaluate the competitiveness using NRCA, the information on 50 top competitor countries and Bangladesh exporting the same product to the same 10 destination countries was considered. After calculating the NRCA values, the degree of competitiveness was defined as follows: highly competitive - if the product is ranked in the top 10; moderately competitive - if a product is ranked within 10-20; marginally competitive - if a product is ranked below 20. The detailed list of products by various competitive categories can be found in ERD (2024c) and is available at https://ssgp.erd.gov.bd/resources/#tab-1691662644167-2-8.

Table 3.4: Distribution of non-RMG exports by average anti-export bias and competitiveness

Product Category	Competitiveness	Average anti- export bias (EERm/EERx)	Export value (million US\$)	Share of Total Non- RMG exports (%)
All non-RMG	Highly competitive	1.260	5032	69.13
products (excluding firearms, alcohol, automobiles & tobacco)	Moderately competitive	1.195	1083	14.88
	Marginally competitive	1.153	1060	14.56
	All	1.20	7175	98.58

Source: ERD (2024c). Estimation using EPB and UNCOMTRADE data.

Note: EERm represents the effective exchange rate for imports, while EERx implies the effective exchange rate for exports. The share of total non-RMG exports does not sum to 100 per cent because products such as firearms, alcohol, automobiles and tobacco (demerit goods where tariffs discourage consumption or are imposed for revenue) have been excluded during the calculation of anti-export bias. The total value of exports of non-RMG products, including those products, comes out to be \$7,278.65 million.

The textile and clothing industry in Bangladesh is also subject to high tariff protection, but the apparel export industry manages to evade the anti-export bias because of its unique circumstances (Razzaque et al., 2024c). Being exclusively export-oriented means its BTE firms have focused solely on export orders, which strategically steers their operations away from local market competition. Given that an export-oriented RMG unit is precluded from domestic sales in a highly protected market, it can exclusively capitalise on export incentives such as cash assistance, interest rate subsidies, and bonded warehouse facilities, thereby securing a competitive edge. This unique market positioning is further reinforced by substantial tariff preferences, which serve to enhance their competitiveness on a global scale.

The relative disincentive for exporters (or anti-export bias) in Bangladesh has been aggravated by inadequate domestic market standards (Razzaque et al., 2024c). The absence of robust domestic standards creates a substantial quality gap between local industries and international markets. As a result, domestic products often fail to meet the quality requirements of global markets, diminishing their competitiveness in exports. This situation particularly discourages non-RMG

producers, especially those with limited resources, from pursuing export opportunities. Consequently, there is an immediate limitation on export potential, which negatively impacts the long-term global reputation of Bangladeshi products, perpetuating a cycle of reduced export interest.

Local entrepreneurs may view the absence of rigorous domestic standards as a reason to avoid exporting due to the additional compliance costs involved. At the same time, without the enforcement of standards in the domestic economy while shielded by high tariff protection, local producers lack the incentive to enhance product quality and innovate their supply chain. For example, many global buyers have ceased sourcing leather products made from local hides due to their failure to comply with global environmental standards, yet products intended for the domestic market remain unaffected.58

As the domestic market is relatively large and growing rapidly, many firms prioritise local sales, neglecting the need to align with international quality benchmarks. The lack of effective enforcement of local standards results in numerous firms being poorly prepared for export activities, particularly to major developed country markets such as Canada, Japan, the EU, the UK, and the USA. Specific sectors like agriculture, processed foods, leather, and fish encounter significant challenges due to the rigorous regulations and standards required by these markets (Razzaque et al., 2024a). Additionally, the lack of domestic testing facilities and certifying capacity poses a challenge for improving standards and compliance in the country.

Another factor contributing to the dichotomous product structures and affecting export competitiveness is the perceived reliance on import tariffs for government revenue. Although the share of government revenue from imports has decreased since the early 2000s, it still constitutes about 30 per cent (Figure 3.5). Consequently, concerns over potential revenue losses undermine efforts to rationalise tariffs to address the inherent bias against exports. Additionally, the demand for protection by local entrepreneurs complicates policymakers' trade policy decisions. Two issues are important to consider in this regard. First, a significant portion of import tax revenue comes from the value-added tax, which will remain in place even with any tariff rationalisation programme, thus exaggerating the concerns over revenue loss. 59 Second, many stakeholders fail to fully appreciate that tariff protection for the domestic import-competing sector also negatively impacts export competitiveness.

⁵⁸ The Tannery Industrial Estate, Dhaka, has for long suffered from an ineffective central effluent treatment plant (CETP) and solid waste management. Consequently, pollution from crust leather product acts as a bottleneck for the industry as it restricts the tanneries from obtaining international quality certifications. These non-compliance issues have adversely impacted the export of leather goods from Bangladesh, as international buyers increasingly demand adherence to environmental and sustainability standards in production processes (Razzaque et al. 2020).

⁵⁹ However, recent estimates from the World Bank indicate that if customs duties and other taxes were reduced to match the levels observed in other middle-income countries such as China, India, or Viet Nam, there would be a significant decrease in government tariff revenue in the range 18 per cent to 41 per cent (World Bank, 2022).

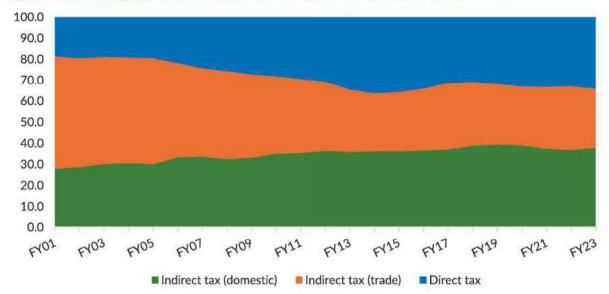


Figure 3.5: Share of government revenue from various sources (%), 2000-01 to 2022-23

Source: Data are from the National Board of Revenue.

3.3 Transforming economic competitiveness: Breaking away from preference dependence and high protection towards high-road economic development

3.3.1 Driving transformation in response to domestic and global challenges

The imminent LDC graduation of Bangladesh should be considered an opportunity for transforming economic competitiveness in a manner that will be sustainable, inclusive, and less dependent on trade preferences and high protective tariffs. In a structurally transformed competitive economy, a rationalised tariff system and modernised trade policy are essential tools for maintaining export competitiveness and a critical point during FTA negotiations with other countries. Competitive economies rely less on protection and trade preferences and more focus on structural transformation, diversification, and innovation in their production line to promote exports.⁶⁰ Reducing reliance on protection motivates domestic industries to enhance efficiency, embrace innovation, adopt best practices, and compete globally, ultimately resulting in higher productivity and ensuring quality and standards. This enhanced competitiveness makes more domestically produced items ready for export and attractive in global markets, helping to diversify exports and reduce vulnerability to policy changes in partner countries. Additionally, a competitive, open economy is more attractive to foreign investors, bringing in capital, technology, and expertise that further boost economic development. Furthermore, when industries rely less on protection, resources are allocated more efficiently based on market demands rather than artificial incentives, leading to more effective utilisation of labour, capital, and technology across the economy.

⁶⁰ Preferences in international trade, outside unilateral GSP schemes, are based on reciprocity and occur under free trade agreements (FTAs) or preferential trading arrangements (PTAs). These arrangements require countries to open up to trade partners to exchange preferences, thereby generating competition and efficiency within their own economies.

Excessive tariff protection raises consumers' costs by increasing the prices of both imported and domestically produced goods, as tariffs act as a tax on imports, which are usually passed on to consumers, resulting in higher retail prices that significantly exceed international market rates. There is some evidence to suggest that during the five-year period from 2012-13 to 2016-17, the total protection cost to Bangladeshi consumers amounted to \$70.6 billion, with domestic prices being, on average, 70 per cent above international prices (Sattar, 2018). For 2016-17 alone, this cost is estimated at \$14.2 billion, which is equivalent to 5.7 per cent of that year's GDP and 31 per cent of the manufacturing value added in the country. When inclusivity is a core development objective, the cost of protection could serve as a significant barrier by disproportionately burdening lower-income consumers, thereby exacerbating income inequality.

A dichotomous production structure, characterised by distinct export-oriented and importcompeting sectors with stark differences in product quality, standards, and working environments, is not in the best interest of the economy. While export sectors strive to improve through productivity and adhering to higher standards to meet international demands, the sustained disparity in the domestic economy obstructs broader economic transformation. This divergence hinders the preparation of the entire economy for global competitiveness, as maintaining lower standards in the domestic sector discourages overall improvement in quality and productivity.

To succeed in today's global market, exporters must comply with a complex landscape of standards, regulations, and consumer expectations. These standards aim to ensure product quality, safety, and sustainability, as well as fair labour practices and minimal environmental impact. By meeting these high bars, exporters gain a competitive edge and build trust and a strong reputation, opening doors to premium markets and minimising the risk of getting shut out by trade restrictions. For instance, in Bangladesh's largest export market, the EU, exporters must navigate several stringent requirements to remain competitive and compliant. Under the GSP+, the most generous preferential trade regime in the EU that a country can access after its LDC graduation, beneficiary countries are required to comply with core international conventions on human rights, labour rights, environmental protection, and good governance to benefit from reduced tariffs. Furthermore, the EU has introduced the Carbon Border Adjustment Mechanism (CBAM), which requires exporters to account for the carbon footprint of their products, aiming to prevent carbon leakage/emissions by imposing costs equivalent to the EU's carbon pricing.⁶¹ Additionally, the EU's due diligence regulations mandate that companies ensure their supply chains are free from human rights violations and environmental harm, necessitating rigorous monitoring and transparency. Many other countries, including the United States, are also focussing on labour and compliance issues in bilateral discussions and in considering preferential market access.⁶²

⁶¹ The EU Carbon Border Adjustment Mechanism (CBAM) currently covers five sectors: cement, iron and steel, aluminium, fertilisers, and electricity generation. This mechanism is designed to prevent carbon leakage by imposing a carbon price on imports of these goods, aligning them with the EU's carbon pricing policies. There is potential for the CBAM to be expanded in the future to include additional sectors as the EU continues to refine its approach to achieving climate neutrality by 2050 (European Commission, 2024).

⁶² The US discontinued GSP preferences for Bangladesh in 2013 following the Rana Plaza building collapse that highlighted hazardous working conditions in the garment industry.

Higher standards and compliance requirements are increasingly necessary as companies respond to growing customer demand for ethically produced goods, driven by heightened awareness and expectations for corporate responsibility, with consumers becoming more sensitive to labour conditions and environmental sustainability. Simultaneously, these requirements are being reinforced by changes in global political circumstances. Recent analyses indicate that trade agreements are progressively aimed at incorporating human rights considerations, reflecting a broader trend of aligning trade policies with ethical and social objectives (Saha & Khorana, 2021). For example, many contemporary trade deals now include clauses that address labour rights and environmental standards, driven by growing public and political pressure to ensure that economic activities do not exacerbate human rights abuses or environmental degradation.⁶³

With the rise in geopolitical tensions globally, labour standards and human rights issues are becoming increasingly prominent in international trade. Trade policy is now more intertwined with geopolitical risks and is also utilised as a means to further broader foreign policy goals, such as safeguarding national security, addressing climate change, and promoting human rights (Chattam House, 2022). Geopolitical shifts have intensified scrutiny on the ethical dimensions of trade, with governments and international organisations advocating for stronger human rights monitoring mechanisms within trade agreements and trading arrangements (Zerk & Beacock, 2021). Such measures are seen as essential to mitigating the negative impacts of global trade on vulnerable populations and ensuring sustainable development. Despite challenges in implementation, the trend towards integrating human rights into trade policy is gaining momentum, highlighting the critical role of ethical considerations in shaping future trade landscapes.

While compliance with these multifaceted requirements enhances market access and competitiveness, it can impose significant compliance costs and operational challenges for exporters, particularly for micro, small, and medium-sized enterprises (MSMEs), potentially limiting their ability to compete at the global level if they lack the necessary resources and infrastructure. However, neglecting to improve compliance is not an option for an economy that aims to foster competitiveness through further structural transformation. Rather than focusing solely on pricebased competition, new sources of competitiveness increasingly demand improved standards in environmental, social, and governance (ESG) criteria to meet evolving consumer expectations and regulatory requirements.

3.3.2 Taking a high-road economic transformation approach

The concept of "high-road economic development" refers to a strategy that emphasises sustainable and inclusive growth through the enhancement of productivity, innovation, and quality standards rather than relying just on low-cost competition (Patluang, 2018). This approach advocates for driving innovation and productivity through investments in education, skills development, and

⁶³ Saha and Khorana (2021) find that since 2013, over 80 per cent of trade agreements have incorporated labour provisions, and more than 40 per cent of agreements since 2000 have included anti-corruption and anti-bribery clauses that surpass WTO requirements. This trend indicates that trade agreements globally are increasingly mandating partners to adhere to specific human rights conditions, encompassing labour standards, political participation, environmental concerns, and standards related to particular goods.

technology to build a highly skilled workforce, supporting women's greater labour force participation.⁶⁴ It also includes a strong focus on improving labour standards, environmental protection and sustainability, and social equity, ensuring that economic growth benefits a broad segment of the population. By prioritising these factors, countries can shift towards a structurally transformed economy that is more resilient and competitive economies, attract higher-quality investments, and ensure long-term sustainable development that is less vulnerable to the pitfalls of low-cost, low-value-added competition. This approach relieves the pressure of low wages and cost-cutting on standards and compliance, allowing for better labour rights and environmental protection and ultimately building brand value based on quality, ethical standards, and sustainability. It not only promotes a fairer distribution of economic benefits but also positions industries to compete globally.

Global firms are increasingly driven by compliance with ESG standards, influenced by regulatory requirements and consumer demand for ethically produced goods (Thomson Reuters Institution, 2024). This shift is partly due to heightened scrutiny from shareholders and stakeholders, who demand greater accountability and transparency throughout supply chains. For example, the EU's Corporate Sustainability Due Diligence Directive (CS3D) requires companies to manage the environmental and social impacts of their value chains, with severe penalties for non-compliance. Such regulations make ESG considerations a critical part of business strategy, compelling firms to ensure their suppliers adhere to high standards to mitigate risks and protect their reputations (Kengelbach et al., 2024).

To achieve such an economic transformation, it is imperative to reduce the disparities between export and non-export industries regarding product quality, labour standards, and environmental concerns. Ensuring high standards across all sectors will create a level playing field, fostering competitiveness based on excellence rather than cost-cutting measures. This harmonisation encourages domestic industries to innovate and improve, benefiting from the same rigorous practices that make export industries successful. Moreover, consistent standards bolster the overall reputation of a country's products, enhancing brand value and consumer trust globally. By integrating high standards universally, the economy can sustainably grow, attract higher-quality investments, increase adaptability of human resources to move across industries and sectors, and ensure long-term resilience and prosperity.

In a transformed economy that emphasises high standards and innovation, the protection policy should focus on strategic support rather than broad-based high tariffs (Figure 3.6). The role of rationalised tariffs in such circumstances is to provide time-bound protection to specific industries and sectors, preparing them to ultimately compete effectively in both the global and domestic markets. The policy instruments could also include targeted support for research and development,

⁶⁴ The concept of high and low road economic developments is also used in the context of employers. For instance, according to OECD (2017), employers can be broadly categorised based on their strategic approach: those that adopt "high road strategies" view employees and their skills as crucial to the business's competitive edge, while those following "low road strategies" treat labour as a commodity, focusing on minimising worker-related costs. See, https://www.oecdilibrary.org/sites/9789264281394-4-en/index.html?itemId=/content/component/9789264281394-4-en

incentives for green technologies, and investments in education and workforce training. Such a strategy nurtures sectors with high growth potential and encourages industries to compete on quality and sustainability rather than low costs, aligning with global market demands. It is worth noting that if market access preferences related to LDC status are lost, along with the ability to provide export subsidies, while tariff protection remains, the resulting policy will further intensify the anti-export bias.

The transformative approach will pave the way for many domestic market products to achieve their export potential rather than solely handpicking the perceived winners for policy support. Successive export policies in Bangladesh have made various efforts to identify potential export sectors based on their initial growth performance, but success has been limited. However, when transformational conditions are fulfilled, moving across the product space encompassing all possible interlinked outputs that a country can produce becomes more feasible, leading to export diversification. The product space, as in Figure 3.7, depicts a map of all merchandise export items, indicating how individual products are linked to one another. Towards the centre of the space, product linkages are dense, implying that if a country's products lie at or close to the centre, exporting related products is easier. The central part of the space includes products such as machinery, heavy industry items like automobiles, chemicals, and capital-intensive goods. In contrast, when products are at the peripheries of the product space, countries exporting these items find it very difficult to move into other sectors. Mineral resources such as petroleum and metals, along with other basic commodities, are mostly located at the margins of the product space.

represents weak/poor impay/finkage represents strong impas/finkage Trade logistics, and customs procedure Environmental, social, and governance Women participation, equality, and inclusivity Labor productivity and standards SMEs and CMSMEs involvement Skills and capacity development Energy officiency and transition Structurally Structurally Transformed Economy / Intellectual property rights Export-oriented sectors Ease of doing husiness Rationalised protection Export diversification Import substitu Productive capacity Product quality Negotlated market Rationalhed tariff (Rouds, energy, ports) (Health, education, social protection) (Product, labour, etivironment) Ouality and compliance Science and . Physical Social infrastructures Smooth Transition Figuresial and capital market Macroeconomic factors Dobt sustainability Eschange rate Tariff policy Fiscal policy Interest rate Juvestment International partnership and assistance Foreign direct investment Domestic resource mobilisation LDC-specific trade preferences Export subsidies Weak standard and low product quality Private sector Existing Structure Government Export-oriented sectors Capacity building nstitutions Rule of Law Filiph on Anti-export bins High tariff protection Development partners

Figure 3.6: Using LDC graduation for economic transformation

Source: Illustration prepared for this Strategy.

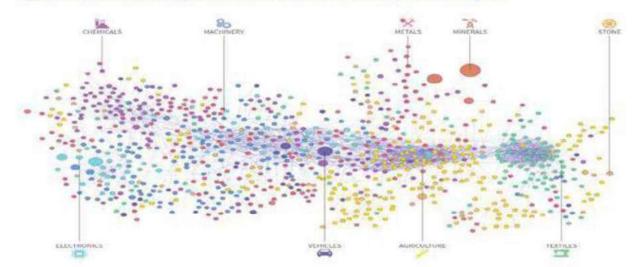


Figure 3.7: Global product spaces and locations of some selected product categories

Source: Hausmann, R. and Hidalgo, C.A., (Hidalgo & Hausmann, 2009). The Atlas of Economic Complexity: Mapping Paths to Prosperity. Cambridge: MIT Press. Available at: https://atlas.cid.harvard.edu/

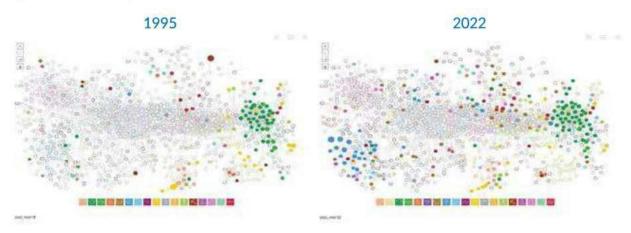
The product space of Bangladesh is mainly characterised by a strong presence in the garment clusters, as indicated by green dots, and it remained almost unchanged between 1995 and 2022 (Figure 3.8 & Figure 3.9). On the other hand, the same map for Viet Nam shows significant expansion beyond the garment cluster since 1995, with the most recently expanded activities in the clusters on broadcasting equipment, office machine parts, and semiconductor devices (Figure 3.9). From its product space mapping in 1995, it would be very difficult to predict that exports would be expanded to these new sectors. This is where the role of a transformative approach is needed in recognising the growth potential of many different sectors that may not be prominent now.

According to an assessment of Bangladesh's current product space composition, there are as many as 584 products at the HS 6-digit level in which Bangladesh exhibits moderate to high competitiveness. Additionally, there are 316 products that Bangladesh currently lacks competitiveness with, as demonstrated by the revealed comparative advantage (RCA) assessment, but comparator countries such as China, India, and Viet Nam are exporting these goods. Producing and exporting sophisticated products generate improved export earnings prospects and improved wages for workers compared to simpler products. However, it is essential to determine whether a country has the required factor endowments to produce such complex products. The product space analysis identifies more than 200 relatively sophisticated items within Bangladesh's reasonable endowment capacity (ERD, 2024c). These products, mainly in electronics, engineering, chemicals, machinery, and processed agricultural goods, offer diverse opportunities for export diversification. Therefore, while there is no shortage of potential, the current production incentive structure, limited productive capacity, lack of preparation regarding standards and compliance, and barriers to mobilising investment are all hindering the expansion of exports.

1995 2022

Figure 3.8: Product space of Bangladesh, 1995 and 2022





Source: Hausmann, R. and Hidalgo, C.A., (Hidalgo & Hausmann, 2009). The Atlas of Economic Complexity: Mapping Paths to Prosperity Cambridge: MIT Press. Available at: https://atlas.cid.harvard.edu/

There is strong evidence that the mix of goods a country produces and can export is an important determinant of its future growth potential, suggesting the significance of relatively complex and sophisticated higher-value-added products and diversifying exports to foster long-term economic development (Hausmann et al., 2007). This approach highlights the importance of local cost discovery and knowledge spillovers in shaping specialisation patterns, which are not solely determined by existing endowments but can also be influenced by the learning and adaptation processes within the economy.65

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⁶⁵ Local cost discovery is the process by which firms learn and adapt to the real costs of producing new and complex goods. This involves experimenting with production techniques, assessing input costs, and understanding necessary infrastructure and labour capabilities. The insights gained enable firms to produce goods more cost-effectively, leading to broader knowledge spillovers within the economy. These spillovers enhance overall industry efficiency and productive capacity, supporting economic growth by building capabilities for more advanced and higher-value-added products, thus increasing a country's economic complexity and long-term growth prospects.

△ Non-LDCs • LDCs **Economic Complexity Outlook Index** IND 2 IDN 1 △ A PHL 0 ΔΔ Δ -1 More Complex -2 -3 -2 -1 0 1 2 3 **Economic Complexity Index**

Figure 3.10: Economic complexity and diversification potential

Source: (Growth Lab, n.d.). The Atlas of Economic Complexity, Harvard University Center for International Development, https://atlas.cid.harvard.edu/

Countries with higher Product Complexity Index (PCI) values are shown to have greater prospects for diversified activities and economies (Figure 3.10), i.e., countries specialising in more complex and higher-value-added products tend to experience faster and more sustained economic growth. Bangladesh (BGD) has a relatively low ECI, indicating a focus on simpler manufacturing items, and a low ECOI, suggesting limited potential for diversification into more complex products. To transition from producing simpler manufacturing items to more complex and sophisticated products, Bangladesh must invest more in education and skills development to cultivate a highly skilled workforce essential for advanced technologies and processes, as the current public spending on education is just above 1 per cent of GDP and less than 1 per cent on health. Finhancing infrastructure, such as reliable energy supply, efficient transportation networks, and digital connectivity, is crucial to support sophisticated manufacturing. Fostering an innovation ecosystem through research and development incentives, technology transfer, and public-private partnerships can drive technological advancements. Additionally, improving standards and compliance frameworks to meet international quality and environmental standards will enable access to high-value markets. Creating a favourable business environment with streamlined

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⁶⁶ The Economic Complexity Index (ECI) measures the sophistication and diversity of a country's export products, while the Economic Complexity Outlook Index (ECOI) predicts the potential for future economic growth based on current capabilities. Each year, the Harvard University Centre for International Development's Growth Lab evaluates countries around the world for economic complexity. The Economic Complexity Index (ECI) examines how many products a country exports, as well as the complexity of those products, and then scores each country. Higher scores indicate a more complex export economy. A complement to the ECI, the Complexity Outlook Index (COI) is a measure of how many complex products are near a country's current set of capabilities. A high COI value indicates that the country's industries have the capability to manufacture a wide variety of complex products.

⁶⁷ The UNESCO's Education 2030 Framework for Action stipulates a target of at least 4 per cent of GDP as public spending in education. The 8th Five-Year Plan of Bangladesh proposed to increase it to 3 per cent by 2025. On the other hand, based on a wide range of evidence and comparisons across countries, the public spending on health should be 3-5 per cent of GDP for developing countries.

regulations and investment incentives is vital in attracting the necessary capital for industrial upgrading.

3.4 Transitioning towards a structurally transformed economy in the context of LDC graduation

To transition towards a structurally transformed and competitive economy, it is essential to address both policy approaches and core enablers. Policy approaches involve strategic reforms such as rationalising tariffs to enhance trade policy flexibility and address anti-export bias, effective macroeconomic management for boosting trade competitiveness, options for mobilising resources, etc. Core enablers, on the other hand, are foundational elements that support these policy measures to achieve the ultimate policy objectives, including significant investment in human capital to develop a skilled workforce, fostering innovation and digitalisation for productivity and efficiency gains, adhering to international standards in product quality and compliance to success in export markets, infrastructure development to improve competitiveness, integrating sustainable practices to maintain environmental and economic resilience, etc. Together, these policy approaches and core enablers can provide a comprehensive framework for achieving sustainable economic growth and global competitiveness.

While many of the essential ingredients for transformative changes are already in place, it is now crucial to consolidate the progress made so far. It is also essential to critically assess where policy reforms are needed and focus on the practical, effective implementation of changes in areas still lagging behind. This will involve ensuring that policy directions are aligned with these foundational elements, promoting cohesive strategies that leverage existing strengths. However, without addressing other existing gaps and pushing for meaningful progress, the potential for real transformation may stall, reflecting that the initial efforts are insufficient.

3.4.1 Policy approaches

Given the impending LDC graduation, Bangladesh's strategic option to move towards a structurally transformed economy and harness new sources of competitiveness will require comprehensive policy approaches. First and foremost, dealing with the incentive system that maintains the dualism of export and non-export sectors will be important. A rationalised tariff structure should help reduce the anti-export bias, and this is extremely important as after LDC graduation, continuing with export subsidies would not be possible, and maintaining the status quo for the importcompeting sector would only make the current perverse export incentive worse. A National Tariff Policy (NTP) has already been put in place, highlighting the importance of tariff rationalisation and providing broad outlines of possible measures that need to be undertaken. The NTP introduces measures such as allowing firms to import inputs for exports duty-free, up to 70 per cent of export value, ensuring a level playing field for all exporters. The policy also recognises the significant antiexport bias of current incentives and seeks to safeguard consumer interests by lessening the impact of higher tariff-induced prices. The policy's assertive approach to dealing with difficult reform measures is highlighted by its high-level implementation committee.

However, the implementation of the NTP should be an immediate priority to provide the trade policy flexibility that Bangladesh needs to negotiate market access opportunities through free trade agreements (FTAs). Major export markets such as China, India, and Japan have shown interest in economic partnership agreements (EPAs)/FTAs with Bangladesh. Without potential tariff reduction/rationalisation commitments, undertaking these negotiations is not possible. However, continuing to rely heavily on import-based revenue restricts this flexibility. Therefore, like most other countries, Bangladesh must diversify its sources of government revenue by, among other measures, enhancing direct taxation and strengthening the Value Added Tax (VAT) system.⁶⁸ When the proportion of direct tax is low, it is not easy to use fiscal policy effectively to achieve inclusive growth.

Policy improvements for mobilising investments-from both domestic and external sources-are critical as the expected structural changes in the economy will require additional resources. The importance of increasing fiscal space through enhanced domestic revenue mobilisation cannot be overstated. There is strong evidence to suggest that a 15 per cent tax-GDP ratio is a crucial threshold for stimulating inclusive economic growth in developing countries like Bangladesh (IMF, 2016). The very limited domestic revenue effort has kept overall public spending low, with increasing dependence on bank borrowing and external financing until recently, both incurring interest payments, which are already about 14 per cent of the government budget.

Along with improving domestic revenue mobilisation, there is also a need to mobilise additional financing from external sources, including overseas development assistance (ODA) and foreign direct investment (FDI), to support investment in social, physical, technology, and quality infrastructures (as shown in Figure 3.6 above). Policy options available are all interlinked: effective taxation will improve the government's capacity to expand public spending and service additional external financing. This, in turn, will depend on an effective structure for exports and remittances to manage a sustainable foreign reserve situation.

Under the existing structure of production configuration, less flexible policy approaches cannot provide effective boosts to competitiveness. For instance, limited flexibilities in exchange rate management led to a significant real exchange rate appreciation, with the overall real effective exchange rate (REER) appreciating by more than 60 per cent between 2012 and 2020 before falling to 46 per cent in 2023 in the aftermath of major depreciation of the Taka (GED, 2023). The bilateral REERs with China, India, and Viet Nam also appreciated between 25 to 30 per cent, indicating a potential loss of export competitiveness against the major competitors (Figure 3.11 & Figure 3.12). Under a transformed framework, the policy approaches will be compatible so that a more flexible exchange rate (mainly market-determined) can augment export competitiveness along with

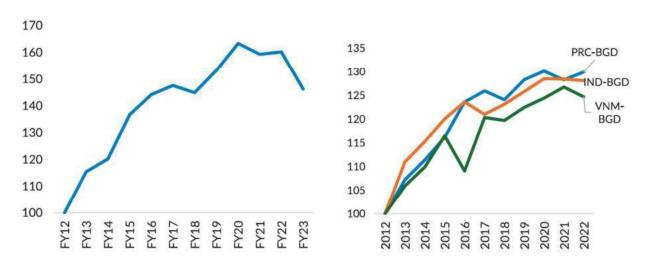
⁶⁸ The challenges facing Bangladesh's tax system have been discussed in many different studies including the 8th Five Year Plan and IMF (2023). Despite over 10 million registered taxpayers, only 38 per cent filed returns, covering just 6.25 per cent of the population. If all eligible individuals paid taxes, personal income tax revenue could rise to 3.1 per cent of GDP from around 1 per cent. Compliance is also low in corporate tax, with only 8.45 per cent of registered companies filing returns in 2022-23. Arbitrary tax exemptions are shown to have resulted in forgone tax revenue equivalent of 2.3 per cent of GDP. Furthermore, the share of direct tax is low in total tax revenue is quite low, at 2.6 per cent of GDP in 2022-23.

supporting non-export sector. In the face of recent unfavourable macroeconomic development, the central bank has already made the policy directions clear.

Policy approaches should also consider the role of any trade preferences that may be available post-graduation in facilitating the transformation. Bangladesh has long benefited from trade preferences, and a gradual decline in reliance on these preferences can help maintain export performance while the economy adjusts and diversifies. This can generate essential revenue and foreign exchange reserves to support broader economic transformation efforts. Additionally, utilising favourable market access conditionalities, especially under negotiated trade deals that provide sustained market access opportunities, can attract foreign investment.

Figure 3.11: Real Effective Exchange Rate (REER) of Bangladesh, 2012=100

Figure 3.12: Bangladesh's bilateral REER, 2012=100



Source: Analysis using data from Bangladesh Bank and International Financial Statistics (IFS), IMF.

Note: BGD = Bangladesh, PRC = People's Republic of China, IND = India, VNM = Viet Nam.

3.4.2 Core enablers of a structurally transformed economy to facilitate a smooth transition of Bangladesh

Productive capacity: Productive capacities, defined as the productive resources, entrepreneurial capabilities, and production linkages that determine a country's ability to produce goods and services, are essential for economic growth and development (UNCTAD, 2006). Improving these capacities is crucial for facilitating structural transformation, enhancing institutional capacity, product quality, enterprise development, supporting export competitiveness, and diversifying exports. Structural change is central to developing productive capacities and setting economies on a positive development trajectory (UNCTAD, 2017). The UNCTAD's Productive Capacities Index (PCI) underscores the importance of enhancing productive capacity for inclusive and sustainable

economic growth and achieving sustainable development goals (UNCTAD, 2023a).⁶⁹ While Bangladesh's PCI is above the LDC average, it still requires significant improvements compared to its peers such as India, Thailand, and Viet Nam (Figure 3.13)

It is worth noting that Bangladesh's economic growth has primarily been driven by the accumulation of labour and capital with minimal technological advancement (ERD, 2024d). However, optimising this growth model by increasing productivity is essential for long-term success. A strong productive capacity base is often associated with technological advancements and efficient production processes. This not only leads to a diversified product range but also ensures product quality and standards, which are critical factors in establishing and maintaining trust in the international market. Bangladesh's productivity growth averaged 3.8 per cent from 1995 to 2016, surpassing the 2.5 per cent average for the 20 Asia Productivity Organization member economies, but this was due to the fact that the country had started from a very low productivity level (Asian Productivity Organization, 2021).

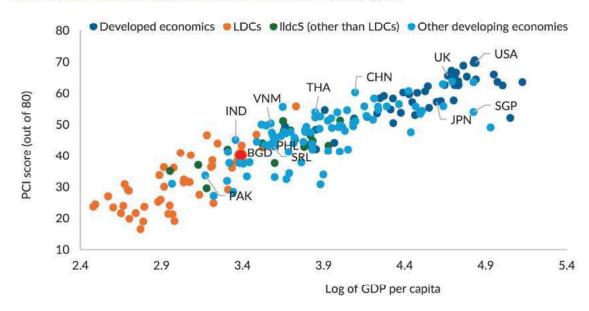


Figure 3.13: Productive capacities index of global economies, 2022

Source: UNCTADstat (2023).

Note: LDCs- Least Developed Countries, LLDCs - Landlocked Developing Countries.

To enhance productivity, a National Productivity Master Plan 2021–2030 was formulated, aiming for an average annual productivity growth of 5.6 per cent from 2021 to 2031 (Box 3.1). This plan emphasises investment in infrastructure, technological advancement, research, and innovation, as well as improving public investment in education, skill development, and healthcare. It also highlights the importance of green initiatives, integrating Fourth Industrial Revolution (4IR) technologies, and strengthening climate resilience. Enhancing the capabilities of MSMEs and CMSMEs is vital for increasing production capacity and fostering backward linkages within export-

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⁶⁹ A robust productive capacity base is linked to five policy areas: development governance, social policy, macroeconomic and financial policies, industrial and sectoral policies, and international support measures. These policies must be pursued in an integrated manner to expand productive capacity and drive structural change.

oriented sectors. Achieving these goals requires a holistic approach that considers various factors and perspectives to ensure successful implementation.

Box 3.1: Five Goals of Bangladesh National Productivity Master Plan 2021-2030

Firstly, the aim is to develop a broad base of productive, innovative, and agile enterprises, transitioning from low-productivity SMEs and large enterprises to high-value-added businesses. This will be achieved by elevating SMEs to escape the low-productivity cycle and scaling up innovative large enterprises.

Secondly, the goal is to establish leading-edge sectors producing high-value-added goods and services, moving beyond subsistence agriculture and labour-intensive manufacturing. This involves promoting productivity in all sectors, modernising and diversifying agriculture, expanding the industrial base, and transforming traditional services into modern, exportable services.

Thirdly, the objective is to create a complex economic structure with deep capabilities and sophisticated products, transitioning from a narrow economic base to high-value-added industries and competitive products (e.g., food and beverage, furniture, and iron and steel basic industry). This will be done by driving growth in new high-value-added industries and strengthening existing core industries.

Fourthly, the focus is on developing robust business enablers, enhancing skills, technology, and the business environment to boost productivity. This includes improving the skills development system, intensifying technology use, and removing business obstacles.

Lastly, the goal is to establish advanced macro enablers to sustain productivity growth, improving the institutional environment, infrastructure, macroeconomic stability, and the state of education and health through collaboration with relevant institutions.

Source: Bangladesh National Productivity Master Plan 2021-2030

Investment: Investment and its diversification across various sectors are key enablers for structural transformation. Promoting foreign and local investment is critical for Bangladesh, especially as it navigates the challenges of graduating from LDC status. The 8FYP aims for investment to reach more than 36 per cent of GDP by 2024-25, with 27.4 per cent of GDP equivalent investment coming from the private sector and the remaining (10 per cent of GDP) from public investment. However, private investment has stagnated at 22-23 per cent over the past decade, and public investment remains modest at 8 per cent (ERD, 2023). This highlights the urgent need to create an investment-friendly ecosystem to boost private investment.

FDI plays a major role in product innovation and enhancing a country's competitive advantage in global markets.⁷⁰ Despite the promises, FDI inflows into Bangladesh remain subdued (Figure 3.14 & Figure 3.15).⁷¹ The recent mid-term review of the 8FYP has also highlighted the lack of progress

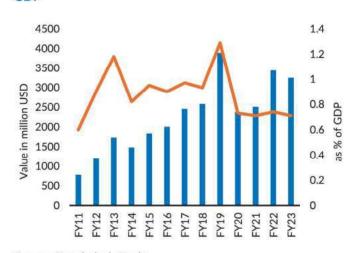
⁷⁰ Viet Nam's export success is driven by FDI, which holds a 60 per cent share of manufacturing exports.

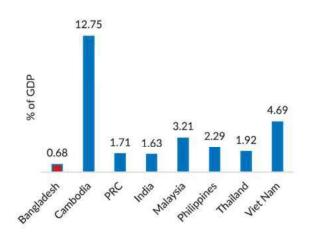
⁷¹ While Bangladesh's net FDI inflow was just \$3.4 billion in 2022, China received \$189 billion, Singapore \$141.2 billion, India \$49.4 billion, Indonesia \$22 billion, Viet Nam \$18 billion, Malaysia \$17 billion, the Philippines \$9.2 billion, and Turkey \$8 billion (UNCTAD, 2023c). Between 1972 and 2005, net FDI inflow in Bangladesh always remained less than 1 per cent of GDP. From 2005 to 2015, Bangladesh saw a gradual but slight rise in net FDI inflows, peaking at 1.74 per cent of GDP in 2013. However, since 2013, net FDI inflow as a share of GDP in Bangladesh has been on the decline. In 2021, FDI was only 0.41per cent of Bangladesh's GDP (ERD, 2023a).

in attracting FDI to the country, aiming to increase FDI to about 2 per cent of GDP in 2022-23 and remaining below 1 per cent (GED, 2023). Beyond increasing capital stock, FDI can drive positive spillovers such as technology transfer, expertise in sustainability, and responsible business conduct (RBC). FDI firms create linkages with local suppliers and improve access to export markets as they are well integrated into global supply chains (ADB & OECD, forthcoming). Amongst others, FDI can help stabilise foreign currency reserves and exchange rate movement.

Figure 3.14: Net FDI inflows into Bangladesh, as % of GDP

Figure 3.15: Average FDI inflows, 2013–2022





Source: Bangladesh Bank.

Source: UNCTAD (2023b)

Note: PRC = People's Republic of China

Despite a relatively open framework for FDI compared to South and Southeast Asian peers, Bangladesh faces challenges in attracting foreign investment. While entry barriers are low, limitations exist. Key service and primary industries are partially restricted to foreign investors, hindering potential economic growth (ADB & OECD, forthcoming).⁷² The investment-related legal framework also lacks modernisation. The Foreign Private Investment Promotion and Protection Act (1980) and the amended Companies Act (1994) need to be updated, given the evolving circumstances. The absence of a commercial court, an older Arbitration Act (based on the 1985 UNCITRAL Model Law), and time-consuming judicial proceedings further deter investors' confidence. Additionally, unpredictable regulatory changes, with nearly 40 per cent of firms experiencing unannounced policy shifts, create uncertainty and undermine investor trust (MCCI & Policy Exchange, 2024). The respective ministries and departments have made significant efforts to attract more FDI by enhancing institutional capacity, improving the ease of doing business, and fostering an investment-friendly environment. Various initiatives have been undertaken, including establishing the Bangladesh Investment Development Authority (BIDA) and introducing one-stop

⁷² The restricted sectors include logistics, maritime transport and air transport, where foreign shareholding is limited to 49 per cent. In telecom, a maximum shareholding of 70 per cent is allowed for telecom towers and nationwide ISPs, but divisional/district-specific ISP licenses reserved for local investors. Reciprocity requirements for bank licenses; branches of foreign insurance companies are allowed, but foreign shareholding in local insurers is limited to 60 per cent. In the legal service, only Bangladeshi citizens are permitted to practice law. For Fisheries, 51 per cent of local vessels are owned by Bangladeshi citizens and limited to foreign investors.

services (OSSs) for local and foreign investors, developing Special Economic Zones (SEZs), and enhancing the capacities of the Bangladesh Economic Zones Authority (BEZA), the Bangladesh Export Processing Zones Authority (BEPZA), and Hi-Tech parks. The effective functioning of these entities remains a significant concern. For instance, the development of 100 Special Economic Zones (SEZs) has proven overly ambitious; prioritising the completion and operationalisation of a few SEZs is crucial to kickstart investment activities. Moreover, the Bangladesh Investment Development Authority (BIDA) has struggled to meet its targets and has failed to attract sufficient Foreign Direct Investment (FDI) from potential investors. Factors such as poor coordination among implementing institutions, administrative inefficiencies, non-transparent practices, and weak dispute-resolution mechanisms have collectively deterred foreign investors. Addressing these challenges requires simplifying the regulatory framework, modernising incentive packages, and adhering to commitments made to investors in conjunction with a more open trade regime.

Product quality and standards: Product quality and adherence to international standards are fundamental for export success, establishing a positive market reputation, and fostering long-term competitiveness. Bangladesh must prioritise quality enhancement and compliance with international standards to maintain export competitiveness in the post-LDC period, especially for new products. Quality upgradation, differentiation, and sophistication are linked to better export prices and market expansion. Effective export performance depends on rigorous quality control, including the use of high-grade raw materials, adherence to standards, and sustainable production practices (Razzaque et al., 2020). Quality improvement, along with proper branding, drives increased export demand and premium pricing in both domestic and international markets.

Developing quality-driven infrastructure is crucial for a robust production supply chain. Inadequate quality control has long affected various industries, impacting productivity. A firm-level employers' perception of different sectors finds that inadequate quality control is considered a challenge in pharmaceuticals, plastics, leather, and agro-industry production, while this is hardly a perceived problem for the RMG sector (Figure 3.16). As the firms outside Dhaka are reported to face more difficulties due to limited testing facilities, enhancing BSTI's capacity and establishing more branches at the district level is essential. However, BSTI quality certification should achieve global accreditation, addressing various challenges. Additionally, the privatisation of certification, standardisation, and testing labs is necessary to ensure quicker and higher-quality services. Efforts are currently underway to enhance Bangladesh's national quality infrastructure (NQI) for industrial competitiveness, and key reform areas have already been identified (OECD, 2023). Meeting international quality and safety standards requires a collaborative effort from the government, exporters, and development partners, prioritising investments in advanced laboratories and skilled personnel to ensure efficient and reliable testing and certification processes.

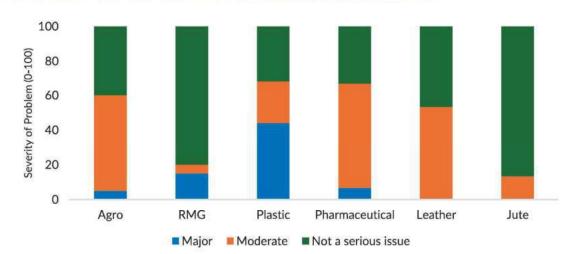


Figure 3.16: Firms' perception about quality control being a major problem

Source: BIDS Primary Survey Data, 2024; ERD, (2024d)

ICT-driven technological progress: Information and communication technology (ICT)-led technological progress has become a key driver of economic transformation, offering opportunities for diversification, productivity enhancement, and quality improvements (Figure 3.17). It facilitates sustainable industrial development by establishing quality standards through digital technologies, modernising sectors, enhancing disaster response, optimising institutional arrangements, and improving tax revenue mobilisation. ICT can also help promote governance, accountability, and traceability and support export diversification through digital services and content trading.

Emerging technologies like IoT and AI are reshaping the global landscape, reducing the advantage of low labour costs (OECD, 2023; Primi & Toselli, 2020). However, accelerating the adoption of new approaches and technologies is key to unlocking structural economic change, as productivity gains are the cornerstone of this transformation, and any delay can weaken the entire process. It has been estimated that increased technology adoption raises export likelihood by 3 percentage points and boosts wages by 8 per cent, indicating the potential of digitalisation to transform Bangladesh's economy (ADB & IsDB, 2023; OECD, 2023).

ICT-led technology and innovation Improve logistics services and ectoral specialisation Productive (e.g., electronics products and software) reduce trade cost Transparency, accountability and Increased labour Improve quality productivity and standards governance Ease of Export Increased doing diversification participation business in GVC **Economic** transformation/ Structural change

Figure 3.17: Structural transformation through digitalisation and innovation

Source: Illustration prepared for this Strategy.

Bangladesh's IT and IT-enabled services (ITES) exports have experienced double-digit growth until 2019-20 but then fell marginally, hovering about \$1.4 billion in 2021-22, with a target of \$5 billion by 2029-30, while the same target was originally envisaged to be reached by 2024-25 (Figure 3.18). However, ICT has also created new employment opportunities, with Bangladesh ranking second globally in the online workforce (Figure 3.19).⁷³ The latest technologies can further improve Bangladesh's participation in GVC through empowering small and medium enterprises (SMEs). This will further foster a new era of "micro-multinationals" where even Bangladeshi SMEs can engage in cross-border commerce via e-commerce platforms (OECD, 2018)⁷⁴. Moreover, E-commerce has been empowering new businesses and increasing women's participation, with over 300,000 online

⁷³ IT sector employs between 127,000 and 400,000, with 15-20 per cent being women. More than 1 million freelancers are working on online or offline in the country whose are earning \$1 billion annually. https://businesspostbd.com/front/2023-04-14/105-lakh-freelancers-bringing-1b-annually-2023-04-14

Micro-multinationals are SMEs taking advantage of the latest technological innovation to extend their reach internationally, expanding globally early in their business lifecycle. They leverage digital technologies and global talent pools to establish a presence abroad swiftly and efficiently (Bharadwa, 2023).

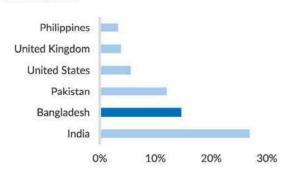
entrepreneurs, half of whom are women (UNESCAP, 2021).⁷⁵ Some of the digitalisation efforts have saved time and costs, enhancing transparency and accountability in public service delivery.⁷⁶ However, the reliance on manual-based digitalisation methods has limited their overall effectiveness. Additionally, the high implementation and operational costs (due to corruption) of these initiatives raise concerns about their long-term sustainability and cost-effectiveness, questioning whether the benefits justify the investment. Bangladesh's technological transformation grapples with numerous challenges, such as non-readiness in adopting frontier technologies, low public expenditure on education and technology, shortage of skilled workforce, and limited industrial R&D investment.

Figure 3.18: Trend in IT-ITes exports of Bangladesh



Source: BASIS (2023).

Figure 3.19: Top online labour supplier in the world (in %)



Source: Oxford Internet Institute (n.d.). Online labour index.

Bangladesh's ranking in the Digital Quality of Life (DQL) Index fell by six positions in 2023, dropping to 82nd out of 121 countries, compared to 76th in 2022, lagging behind global peers such as Malaysia (37th), India (52nd), and Viet Nam (56th) (Surfshark, 2023).⁷⁷ Despite a significant increase in internet usage—from 7 per cent to 44 per cent of the population between 2013 and 2023 (BBS, 2023b)—the cost of internet in Bangladesh remains disproportionately high, being seven times higher than the global average (Surfshark, 2022). Furthermore, in terms of mobile download speeds, Bangladesh ranked 101st out of 162 countries as of July 2024, with an average speed of 48 Mbps, which is only half the global average (Ookla, 2024). This disparity in cost and performance

According to the e-Cab data, around 350,000 people are directly involved with e-commerce businesses while 200,000 more are part-time or homemakers. Some 23 per cent of consumers of e-commerce business are from rural areas while the rest are city-based. https://thefinancialexpress.com.bd/economy/bangladesh/state-of-e-commerce-con-trick-undercuts-roaring-rise

⁷⁵ According to an official of (BTRC), nearly 50,000 Facebook pages sell or supply products retail and wholesale in Bangladesh.

The official estimated that the annual tax and value added tax (VAT) of these Facebook-based ventures could be as much as Tk10,000 crore. https://www.tbsnews.net/economy/bangladesh-e-commerce-sales-more-double-2026-research-497134

⁷⁶ It is estimated that some digital online services in 2022 resulted in savings of 16.83 billion days (71% of time), \$21.92 billion in costs (68% of cost), and 12.7 billion visits (85% of visits) for service recipients, while also ensuring transparency and accountability in public service delivery (a2i, 2023)

⁷⁷ The Digital Quality Life (DQL) index 2023 is published by Surfshark on digital wellbeing across 121 countries (92% of the global population). The index considers five pillars that impact a population's digital quality of life, including internet affordability, internet quality, electronic infrastructure, electronic security, and electronic government.

highlights inefficiencies in the country's digital infrastructure and raises concerns about equitable access to high-quality internet—critical for fostering digital inclusion and economic growth. To address these challenges, the government, private sector, and development partners must collaborate to develop a tech-savvy infrastructure through enhanced training, increased investment in education and technology, and incentives for industrial R&D.

Labour productivity and skill development: The transition towards a productivity-driven economy and successful transformation strategies hinge on knowledge-based skill development and an efficient workforce. The global tendency towards automation and the 4IR-related technological advancements necessitate rapid skill development, making human capital investment through improved education and skill development programmes. These investments will foster an innovation-driven, skilled society that should promote higher participation of women workers. Several East Asian economies, including Japan, South Korea, and Thailand, have successfully upgraded their skill base through publicly-supported education programmes in science and technology at top international universities (GED, 2020a).

A skilled workforce supports structural transformation by empowering local businesses, improving product quality, and aligning migrant workers' skills with international job markets, boosting remittances.⁷⁸ However, Bangladesh faces significant gaps in digital skills, ranking low among global economies, with all the major sectors suffering from a 'moderate' problem affecting productivity due to a shortage of skilled labour as the Survey of Manufacturing Industries (SMI) 2019 data reported only about 28 per cent of workers could be considered as skilled (Figure 3.20 & Figure 3.21).

Figure 3.20: Bangladesh in the Digital Skills Gap Index (DSGI), 2021

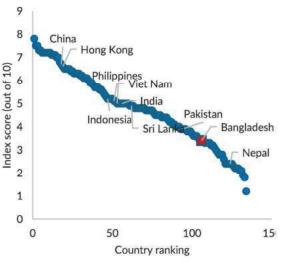
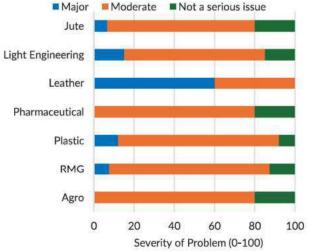


Figure 3.21: Firms' perception about lack of skilled workers hampering productivity



Source: Illustration using the Willey data.

Source: ERD (2024d); ERD (2024c).

⁷⁸ A 1.83 million skilled overseas Filipino workers generated \$36.9 billion in remittances in 2021 (ILOSTAT, 2023), while Bangladesh received \$22.1 billion from more than 10 million migrant workers (Bangladesh Bank and BBS).

The dynamics of skill requirements in the workforce are also evolving over time with a growing dearth of specialised skills, particularly in Science, Technology, Engineering and Mathematics (STEM), and digital fields. The National Skills Development Authority (NSDA) is implementing programmes to overcome the skills gap as part of the "National Skills Development Policy, 2020" along with its "National Action Plan 2022-2027 for Skills Development in Bangladesh.

Paradoxically, while the adoption of automation and technological deepening across various industries poses a significant risk of job loss-with the highest impact projected in RMG and furniture sectors, followed by agro-food and leather-this should not deter or discourage technological adaptation (a2i, 2022). Automation-led employment threats are not limited to developing countries like Bangladesh; this is a global phenomenon. (McKinsey Global Institute, 2017; Razzaque & Dristy, 2018).

As Bangladesh's economy expands, a skilled workforce is essential for enhancing productivity in current sectors and enabling diversification into new areas. Embracing technological advancements will drive growth, improve productivity, and create new opportunities, contributing to a more robust and diversified economy. Achieving higher growth rates of 8-10 per cent annually is now more feasible with technological progress. Effective policy interventions are critical in harnessing these benefits. For instance, micro, small, and medium enterprises (MSMEs), key drivers of domestic economic activity, require support to access technology, thereby improving productivity and competitiveness. However, shielding the domestic economy through high tariffs during capital deepening and technological upgrading can lead to inefficiencies, necessitating a balanced approach.

Technological progress may also increase income inequality by favouring capital income and raising the skill premium. Historically, unskilled workers and women have been disproportionately affected by technological changes (GED, 2019; Tejani & Milberg, 2010).⁷⁹ Therefore, policies must focus on vulnerable groups—such as people with low incomes, women, and unskilled workers—by improving access to quality and affordable education and healthcare and by implementing targeted social policies and progressive taxation. Furthermore, transforming social sectors to generate productive employment is crucial. Investment in health and education remains insufficient, and substantial improvements in quality are needed, as these sectors have significant potential to generate employment opportunities.

Labour standards, compliance, and workplace safety: Labour issues involving fair wages, a safe, harassment-free, and conducive working environment, and workers' rights have become indispensable factors for Bangladesh to meet international standards and safeguard its brand reputation. Continuing with any preferential trade benefits and market access will hinge on demonstrably adhering to best labour standards practices. For instance, 10 of the 32 international

29 per cent in 2022 - a trend is argued to be associated with increased automation (Razzaque and Dristy, 2018).

⁷⁹ Tejani and Milberg (2010) pointed to a global defeminisation process as a result of industrial upgrading. Their research shows that capital intensity in production, as evidenced by shifts in labour productivity, is negatively and significantly related to shifts in the female share of employment in manufacturing. In Bangladesh, according to the BBS labour force surveys, the female shares of employment in the garment sector fell from 57 per cent in 2013 to 46 per cent in 2016 to

conventions required as preconditions for obtaining EU GSP+ status are related to labour standards provisions of the ILO. Following the tragic events at Tazreen Fashions and Rana Plaza, the RMG sector, with the help of development partners and international buyers, has made remarkable progress in workplace safety by implementing stricter safety protocols. Significant progress, however, will have to be made in the non-RMG sector (Moazzem et al., 2022; Moazzem & Mostofa, 2021).

Although Bangladesh has already ratified all the conventions required to avail of GSP+ facilities, these must be effectively implemented. This will require strong enforcement practices and the related investment in administrative infrastructure and effective, accountable factory inspections. More importantly, as labour standards have become a defining feature of export competitiveness, a transformed economy must improve these standards not just to secure trade preferences but to ensure long-term sustainability and brand reputation in the global marketplace, thereby cementing its position as a competitive player on the world stage.

Environmental sustainability: As consumers become increasingly environmentally conscious, companies with robust sustainability practices can significantly enhance their brand image, reputation, and overall competitiveness. This trend underscores the importance of integrating ESG considerations to achieve medium- to long-term export success. Companies that effectively adopt ESG practices are more likely to secure consumer trust, attract responsible investors, and adapt to evolving market demands. The consequences of non-compliance are clearly illustrated by Bangladesh's leather sector, which, despite having a substantial domestic market, struggles to compete internationally due to repeated violations of environmental standards, driving away global buyers and sourcing opportunities. Environmental sustainability is not only fundamental for improving competitiveness but is also crucial for fostering sustainable development beyond the transitional phase. Climate hazards and environmental imbalances can have far-reaching impacts on the economy, particularly on food security, healthy livelihoods, and sustainable agriculture. The negative effects of climate change extend beyond the agricultural sector, putting pressure on water and energy systems, infrastructure, and human settlements, thereby hindering economic growth and broader development. Given these circumstances, prioritising environmental sustainability across all sectors is critical for resilience, ensuring both economic stability and social well-being.

Global greening initiatives have driven economies to commit to reducing greenhouse gas emissions and adopting low-carbon energy sources, aligning with the goals of the Paris Agreement. Major brands and retailers are also taking measures to tackle their environmental footprints (Table 3.5). These initiatives are transforming international trade and investment regimes with implications for export competitiveness. For instance, the EU Green Deal's Carbon Border Adjustment Mechanism (CBAM) aims to internalise CO₂ costs in both domestically produced and imported goods.⁸⁰

⁸⁰ The EU introduced CBAM on imports from October 1, 2023, with importers required to obtain CBAM certificates for selected commodities starting from January 1, 2026. While at the initial stage, Bangladesh is not expected to be significantly affected due to limited product coverage of CBAM. However, the coverage of such measures will likely expand in the future. Thus, the challenge of any loss of tariff preference due to LDC graduation could be compounded by the enforcement of CBAM measures. Furthermore, the EU has issued detailed guidelines on the Strategy for

Initially, the CBAM may not significantly impact Bangladesh; however, the sectoral coverage is expected to expand. Bangladesh's comparator countries, including China, India, and Viet Nam, have either established or are in the process of developing domestic carbon markets to internalise some of the costs, thereby being subject to lower or no CBAM tariffs in the EU. Therefore, along with preparation for LDC graduation, due attention must also be given to preparing for border carbon tax measures.

Furthermore, the recently introduced EU Corporate Sustainability Due Diligence Directive (CS3D), adopted by the European Parliament on April 24, 2024, mandates that companies, both within and outside the EU, engage in thorough due diligence to examine, prevent, and mitigate their negative environmental and human rights impacts, both internally and across their supply chains. This directive is anticipated to bring about substantial transformations in corporate practices, compelling companies to reassess and potentially overhaul their business strategies, sourcing practices, supply chain management protocols, and even product design approaches to adhere to these new regulatory standards.⁸¹

Table 3.5: Greening initiatives by some selected brands

Brand	GHG Emission	Freshwater Usage	Recycled inputs
Н&М	Reduce emissions by 56 per cent by 2030 from the 2019 baseline	Reduce 30 per cent by 2030 compared to the 2022 baseline	100 per cent materials to be sourced either recycled or sourced in a sustainable way by 2030
Nike	Reduce 70 per cent of emissions by 2025 from the 2015 baseline	Reduce 25 per cent freshwater usage per kg textile dyeing and finishing by 2025	Use 100 per cent recycled material for manufacturing by 2025
LEVI STRAUSS & CO	Reduce 90 per cent of emissions from the 2016 baseline by 2025	Reduce 50 per cent from the 2018 base year by 2025	50 per cent waste diversion from the 2018 base year by 2030
Adidas	30 per cent reduction from the 2017 baseline by 2030 and achieve climate neutrality by 2050 in the entire value chain.	Reduce 40 per cent from the 2017 baseline by 2025	Replace all virgin polyester with recycled polyester by 2024.

Source: Annual sustainability reports of respective brands.

Bangladesh is committed to tackling climate change vulnerabilities and encouraging environmental sustainability by lowering CO₂ emissions and transitioning away from fossil fuels, as reflected in

Sustainable and Circular Textiles, advising exporting countries on circular design in the textile industry (European Commission, 2023).

⁸¹ The ambit of CS3D on human rights and the environment is vast, encompassing issues such as the prevention of child labour, slavery, labour exploitation, pollution, deforestation, and damage to ecosystems like excessive water consumption. The overarching aim is to ensure equitable treatment of workers, uphold freedom of association, guarantee a fair minimum wage, and implement measures to combat pollution and the depletion of natural resources.

various policies.82 Sustainability is critical for the future of Bangladesh's RMG sector, as environmental challenges such as groundwater pollution, airborne waste, soil degradation, and noise pollution require immediate attention. Globally, the garments and textile industries account for 10 per cent of CO2 emissions and nearly 20 per cent of wastewater generation, while in Bangladesh, the garment sector is responsible for an estimated 15.4 per cent of the country's CO2 emissions and consuming 250-300 litres of water for every kilogram of cloth produced—equivalent to the daily water use of two individuals (ETI Bangladesh, 2024; OECD, 2023; Sagris et al., 2015).83 Despite policies addressing climate change vulnerability, renewable energy transition is not an easy option given the geographical endowment of the country, including limited hydropower and geothermal potential, land scarcity for solar farms, inadequate electricity infrastructure, and, most importantly lack of capacity, technical knowledge and skilled workforce in the focal ministry and department (i.e., MoEFCC and DoE) for environmental management.84 Transitioning to clean energy will require significant long-term investment and policy commitments.

Moreover, to address climate change risks in Bangladesh, it is important to allocate adequate investible resources to climate-relevant expenditures. Currently, only 9 per cent of the total climate-relevant budget (of 25 ministries) is dedicated to climate-related spending (Finance Division, 2023a). While Bangladesh now benefits from various international climate finance sources, including the Global Environment Facility (GEF), Adaptation Fund, Least Developed Countries Fund (LDCF), Adaptation for Smallholder Agriculture Program (ASAP), Global Climate Change Alliance (GCCA), Climate Investment Funds, UN-REDD Readiness Program, and the recently established Green Climate Fund (GCF), transitioning out of LDCs may result in some cases limited access to funding. Therefore, developing a comprehensive medium- to long-term climate change financing strategy is needed to tap into diverse funding streams to mitigate climate changerelated risks and vulnerabilities and promote and adopt environmental sustainability in the business model to sustain export competitiveness.

Infrastructure, trade logistics, and ease of doing business: Infrastructure, trade logistics, and ease of doing business are vital for competitiveness and driving structural transformation. Adequate infrastructure ensures energy security and facilitates efficient transportation and communication, reducing operational costs. This should be complemented by efficient trade logistics, which lower transportation and warehousing costs, enabling new production models and material sourcing and thus improving brand satisfaction and loyalty. Advanced logistics technologies enhance supply chain visibility, planning, risk mitigation, and bottleneck identification. From a microeconomic

⁸² Bangladesh has adopted several policy documents to mitigate the climate and environmental vulnerability risks: Bangladesh Climate Change Strategy and Action Plan (BCCSAP): 2009, updated to include natural resources management, gender, and urban dimensions of climate change; National Adaptation Programme of Action: 2005, updated in 2009; Bangladesh Climate Change Trust Act: 2010; Nationally Determined Contributions (NDCs): 2015, updated in 2021; NDCs Implementation Road Map: 2018; National Adaptation Plan (2023-2050); National Environmental Policy: 2018.

⁸³ The global benchmark for fabric production is 100 litres of water per kilogram (Sagris et al., 2015).

⁸⁴ Bangladesh aimed for 10 per cent renewable energy by 2024-25 but has reached only 4.46 per cent until now. According to the NDCs, Bangladesh's commitment to reducing GHG emissions unconditionally by 6.73 per cent by 2030 and by an additional 15.12 per cent with international support. There are plans to produce 911.8 MW of renewable energy domestically and 4115.3 MW with international assistance.

perspective, trade logistics reduce transaction costs, while from a macroeconomic perspective, they lower trade costs, foster regional economic integration, and facilitate advantageous trade agreements. A functional logistical network, coupled with an enabling business environment that minimises administrative hurdles and fosters transparency, greatly improves competitiveness.

Despite some improvements in large-scale infrastructure projects, there is a need to make progress in areas such as port services, road and railway systems, and energy generation capacity (World Bank, 2023; MCCI & Policy Exchange, 2023; Zafar et al., 2020). Although Bangladesh has made efforts to address electricity shortages in recent years, its per capita electricity consumption is just about 40 per cent of that in India, 22 per cent in comparison with Viet Nam, and less than 10 per cent of China's (Figure 3.22). Inefficient logistics have also been shown to hamper export-oriented trade links and business-to-business contacts, particularly outside the established RMG value chains (OECD, 2023; Zafar et al., 2020). Additionally, border and documentary compliance requirements lead to major delays for exporting firms, with an estimated total of more than 300 hours required, among the highest in South Asia (World Bank, 2022b). While Bangladesh performs better than the average of LDCs in the Logistics Performance Index (LPI), its competitive peers in the global market perform much better (Figure 3.23). Bangladesh's export performance is thought to have been hindered by an underdeveloped logistics industry, which has serious implications for the country's external competitiveness (see Box 3.2). To improve the overall logistics system, the country recently developed the National Logistics Policy 2024, identifying critical areas for improvement and aiming to reduce transportation and logistics costs to boost export performance and competitiveness (further details are provided in Chapter 4).

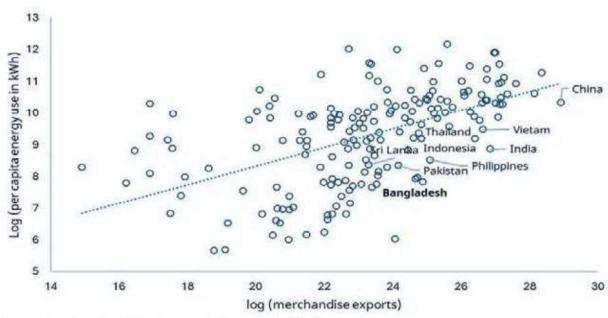


Figure 3.22: Energy use and exports by global economies

Source: Data from World Development Indicators, World Bank.

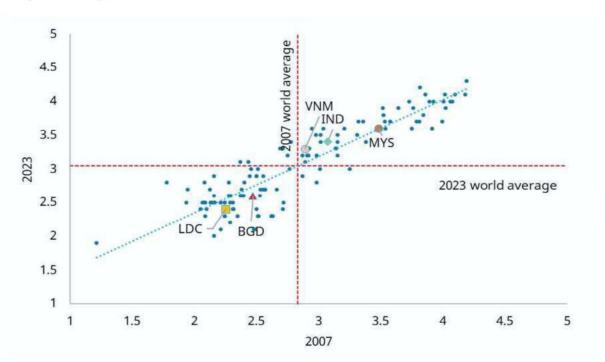


Figure 3.23: Logistics Performance Index (LPI) scores of Bangladesh and other countries (2007 vs 2023) compared to its peers

Source: Logistics Performance Index data, World Bank.

Note: BGD - Bangladesh, IND - India, LDC - Least Developed Countries, MYM - Myanmar, MYS - Malaysia, VNM - Viet Nam.

Box 3.2: Examples of logistics issues affecting competitiveness in Bangladesh

- Bangladesh's logistics costs are high across sectors, ranging from 4.5 per cent for leather footwear to 47.9 per cent for horticulture.
- Inventory carrying costs represent 17–56 per cent of logistics costs; in most industries, the figure exceeds 30 per cent, higher than in many developing countries.
- More than 80 per cent attribute delays in shipments to the poor condition of roads and congestion. Without road congestion, logistics costs would be at least 7–35 per cent lower.
- Trade in South Asia is paper-heavy, requiring physical submission of documents for regulatory requirements, which can account for as much as 3 per cent of the total cost of trade.
- Setting the minimum speed along national highways at 40 km/hour would reduce logistics costs as a share
 of sales by 0.5 percentage points, increasing Bangladesh's exports by 3.7 per cent.
- A 1 percentage point reduction in transport costs as a share of sales would increase demand for Bangladesh's exports by 7.4 per cent.
- The average cost of carrying a tonne a kilometre is \$0.095, which is higher than in many developing and developed countries, including the US, France, Australia, India, and Pakistan.
- Airport support services are a component of logistics, and airport-related charges are higher than in the country. For example, terminal handling charges (THC) are \$0.08A/kg in Bangladesh, compared to \$0.05 in India and Sri Lanka.
- Bangladesh is missing out on at least 20 per cent of its export potential due to poor logistics and clearance services in the country's ports and highways, according to various experts.

91 per cent of service providers focus on one service category, with low skills, poor asset quality, and limited IT tools. Poor driving skills contribute to road crashes, which account for 11 per cent of trucking

Source: Information compiled from the study of Moving Forward Connectivity and Logistics to Sustain Bangladesh's Success; World Bank (2020), and Comprehensive Report on Logistics Sector of Bangladesh; ERD (2024a).

Private sector as the driver of structural transformation: The role of the private sector in driving structural transformation and mitigating any adverse consequences of LDC graduation cannot be overstated. As the engine of economic activity, the sector is ideally positioned to drive innovation, efficiency, and job creation. Bangladesh's entrepreneurial spirit, complemented by policy support from the government, offers an ideal ground for private businesses to flourish. For Bangladesh to achieve a transformed economy, it is imperative that firms from different sectors work collaboratively to improve their standards in critical areas. These include prioritising workplace safety, ensuring decent jobs with fair wages, providing opportunities for professional development through skill development, and improving productivity and quality through compliance with standards.

Firm-level preparedness is crucial for facing LDC graduation-related challenges such as the loss of trade preferences and the lack of export diversification. Firms must proactively seek to diversify their product offerings and markets to reduce dependency on a few export commodities and destinations. This can be achieved through innovation, exploring new sectors, and investing in research and development. Additionally, firms should enhance their competitiveness by adopting advanced technologies, improving product quality, and adhering to international standards.

Role of Institutions: Although institutions, encompassing government bodies, regulatory frameworks, and legal systems, are part of productive capacity, it is important to highlight their distinct role as crucial enablers of economic transformation and inclusive and sustainable development. Advanced industrialised nation-states have benefited from strong institutional frameworks that triggered and sustained economic and political modernisation over long periods of time (GED, 2023). Effective institutions reduce transaction costs, enforce contracts, and provide stability for economic activities, which reduces uncertainty and risk, facilitating smoother business operations and efficient market functioning. By protecting property rights and enforcing the rule of law, institutions create an environment conducive to investment, encouraging both physical and human capital investments that drive growth.85

The critical role of institutions in advancing Bangladesh's development and implementing the STS has been highlighted in the White Paper 2024 commissioned by the Interim Government (White

term development.

⁸⁵ Amongst others, Nobel Laureate economists Daren Acemoglu and Jame Robison have made seminal contributions to demonstrate that the differences in prosperity across countries can largely be explained by the quality of their institutions (e.g., Acemoglu and Robinson, 2012). They argue that inclusive political and economic institutions, which provide incentives for innovation and allow broad participation in economic activities, lead to sustained economic growth. Conversely, extractive institutions, which concentrate power and wealth in the hands of a few, are detrimental to long-

Paper Committee, 2024). Institutional challenges, particularly in governance, project execution, and economic progress, remain deeply rooted. Public infrastructure projects are often flawed by weak feasibility studies, inadequate planning, and poor inter-agency coordination (White Paper Committee, 2024). Despite substantial investments in megaprojects, anomalies such as cost overruns, delays, and a lack of transparency persist, with over 86% of projects experiencing time or cost escalations, thereby undermining economic viability and exacerbating debt burdens. Furthermore, pervasive corruption and non-competitive procurement practices have compromised project quality and outcomes. While the Implementation Monitoring and Evaluation Department (IMED) has repeatedly flagged inefficiencies, limited accountability continues to hinder the achievement of intended objectives. Without reforms, including stricter oversight and accountability mechanisms, the cycle of inefficiencies and wasted resources will likely continue, undermining the country's progress and its potential to achieve broader developmental goals.

In dealing with these challenges, the importance of strong institutions becomes even more apparent. Strong institutions promote good governance by fostering transparency, accountability, and inclusive decision-making, ensuring economic benefits are widely shared, thus reducing inequality and fostering social stability (Raihan, 2023). They are also critical in developing and maintaining essential infrastructure, such as roads, schools, and hospitals, which are necessary for a productive workforce and long-term growth. Furthermore, institutions support innovation by protecting intellectual property rights and providing a framework for research and development, driving productivity and economic diversification. Effective institutions help mitigate conflicts and ensure political stability, creating a conducive environment for economic activities. They create a business-friendly environment by simplifying regulatory processes and reducing bureaucratic hurdles, improving the ease of doing business, and mobilising both domestic and international investments.

In contrast, corruption-ridden, weak, and ineffective institutions undermine development efforts, compromise economic stability, and erode public trust. Along with this, when political interference with the help of manipulated economic data further obscures the true state of the economy, damaging investor confidence. The consequences of institutional weakness are far-reaching, stifling innovation, worsening inequality, and weakening economic fundamentals. To overcome these challenges, Bangladesh must strengthen accountability mechanisms, promote good governance, and build sound and credible institutions by undertaking deep-rooted reform measures.

3.5 Sources of enhanced competitiveness

Following LDC graduation, Bangladesh faces the challenge of losing export competitiveness due to the cessation of LDC-specific trade preferences. However, the transformative changes discussed above can significantly outweigh preference-driven competitiveness, as evidenced by various studies and analyses available in the context of the global economy and Bangladesh.

- Improved trade logistics can significantly enhance export competitiveness. It is found that a 1 per cent decrease in transport costs by 1 per cent can enhance export earnings by 7.4 per cent (Table 3.6). The implementation of the WTO's Trade Facilitation Agreement could increase global trade by \$1 trillion, from which countries like Bangladesh could benefit. It has also been suggested that developing countries can raise their exports by about 10 per cent by reducing half of the existing gap in the trade facilitation indicators.
- There are many empirical studies that show that improvements in customs clearance procedures lead to enhanced export performance. Administrative hurdles causing delays in customs procedures raise the cost of import by about 7 and 10 per cent of world trade.
- There are strong theoretical arguments and empirical findings to suggest that avoiding real exchange rate overvaluation can boost the external competitiveness of a country. For many years, as shown earlier, Bangladesh had maintained an appreciated real exchange rate, and thus, corrective measures could help with export performance. Evidence shows a 10 per cent depreciation in RER can lead to a 6 to 8 per cent increase in exports (Table 3.6)
- Enhancing product quality can significantly boost exports, with the evidence of higherquality goods leading to a 62 per cent increase in export quantities without lowering prices and a 10 per cent improvement in quality, resulting in a 1.5 per cent rise in export performance for Malaysia's electrical products (Muhammad & Yaacob, 2009).
- Attracting foreign direct investment (FDI) can integrate Bangladesh into international markets and drive innovation, with a 10 per cent rise in FDI boosting exports by 1.6 per cent.

Amongst others, trade liberalisation/tariff rationalisation is known to be associated with allocative efficiency gains. In the context of Bangladesh, it has been suggested that a 25 per cent reduction in import tariffs across all sectors could potentially increase export earnings by approximately 8 per cent and imports by 4.4 per cent. Furthermore, unilateral trade and investment liberalisation in Bangladesh could significantly boost the country's GDP, investment, and exports by 14.8 per cent, 20 per cent, and 63.2 per cent, respectively.

It follows from the above that there is tremendous room for improvement for Bangladesh across all the areas mentioned, generating significant benefits for the country. Until now, they remain challenging in the absence of necessary policy reforms. However, by addressing these challenges head-on, it is possible to transform them into opportunities. Many of these reforms, such as streamlining customs procedures, tariff rationalisation, improving logistics, and enhancing product quality, should be seen as low-hanging fruits that can quickly yield substantial benefits.

Table 3.6: Selected means of enhancing export competitiveness in the post-LDC era

Areas of competitiveness	Impact on competitiveness (selected evidence)
Trade logistics	-A 1% decrease in transport costs can lead to a 7.4% surge in export demand in Bangladesh (World Bank, 2020).
Trade facilitation	-The implementation of the Trade Facilitation Agreement (TFA) can reduce the trade cost by up to 11%-14% (World Bank & UNESCAP, 2022) and has the potential to increase global merchandise exports by up to \$1 trillion per annum ((Ala, 2013)).

	-Developing countries can raise their exports by 9.9% by reducing half of the existing gap in the trade facilitation indicators (Hufbauer & Schott, 2013) -Export earnings of Bangladesh could increase 30% with higher port efficiency (OECD, 2005).
Avoiding overvaluation of	-An appreciated real exchange rate negatively impacts exports, with a 10% appreciation reducing exports by 22-23%, while a 10% depreciation increases exports by 6-8% (Stojanov et
the exchange rate Borders and customs cleaning procedures	al., 2024), and GDP by 1.5% of GDP increase in real net exports (Leigh et al., 2017). -Longer import processing times reduce total exports in Thailand (Hayakawa et al., 2019)A 10% reduction in inbound border processing times within the Central Asia Regional Economic Cooperation (CAREC) region could boost intra-regional trade by 1.41% (ADB, 2020)Red tape in customs procedures increases the cost of import by about 7%-10% of world trade (Beverelli & Ticku, 2022; Messerlin & Zarrouk, 2000)
Ease of doing business	 -Innovation has a strong connection with the encouragement of entrepreneurship, which relies on the ease of doing business (Robinson & Acemoglu, 2012). -Ease of starting a business has a positive relationship with business creation (Canare et al., 2019). -Difficulties in dealing with construction permits, getting credit, paying taxes, and protecting minority investors have a negative impact on attracting FDI (Haliti & Merovci, 2019).
Product quality and standards	-By exporting higher-quality goods, larger quantities (62%) can be exported without lowering the prices of the products (Guasch et al., 2007; Hummels & Klenow, 2005). -A 10% enhancement in product quality leads to a 1.5% upsurge in the export performance of electrical products from Malaysia (Muhammad & Yaacob, 2009).
Foreign direct investment (FDI)	-FDI helps developing economies to integrate into international markets, gain spurs productivity by increasing competition, enabling knowledge to spread across borders, and drive innovation (Gonzalez, 2017). -A 10% rise in foreign direct investment can lead to a 1.6% boost in Bangladesh's exports (Bangladesh Bank, n.d.). -The export value of the foreign direct investment (FDI) enterprises accounts for over 70 per cent of Viet Nam's total export value (Association of Foreign Invested Enterprises, 2022).
Trade liberalisation and tariff rationalisation	-Trade liberalisation can improve allocative efficiency by shifting resources to where they can be most productive based on comparative advantage (Krugman, 1979; Bhagwati, 1990) -Developing countries would gain more from global trade liberalisation as a percentage of their GDP than industrial countries (IMF & World Bank, 2001)The benefits of trade liberalisation can exceed the costs by more than a factor of 10 (Tarr & Matusz, 1999) -A 25% reduction in import tariffs across all sectors could potentially boost export earnings by approximately 8% and imports by 4.4% (Razzaque et al., 2021)Unilateral trade and investment liberalisation could boost Bangladesh's GDP, investment, and exports by 14.8%, 20%, and 63.2%, respectively (World Bank, 2022a).
Free trade agreements and regional trade agreements	-Comprehensive bilateral Free Trade Agreements (FTAs) with the EU and India could boost Bangladesh's GDP by 0.4 and 0.5%, respectively, and exports by 1.4% and 3.9% (World Bank, 2023)FTAs/RTAs help increase FDI flows in the member states (Thangavelu & Findlay, 2011)
Regional integration	-Bangladesh's gains from a deep regional integration (with South Asian countries) would be 10 times higher compared with shallow regional integration relying on tariff cuts only. The GDP gains would increase from 1.4% in the shallow regional integration scenario to 14.3% in a deep regional integration setting. The increase in exports would also rise from 6.8% to 41.5% (World Bank, 2023).

⁸⁶ It needs to be pointed out that depreciation in the real effective exchange rate does not imply depreciation of the nominal exchange rate alone. Depreciations will lead to rise in inflation which can also adversely affect external competitiveness. A host of factors such as terms of trade, trade openness, economic growth, government expenditure, capital controls, etc. can affect real exchange rate movements. Therefore, a careful assessment is needed to understand the changes in the real exchange rate.

	-Bangladesh has the untapped potential for regional trade (in South Asia) of about 93% (World Bank, 2022c).
Technology upgradation and innovation	 -Adopting advanced technologies in production can lead to a 2.5 percentage points annual increase in trade growth of developing countries (WTO, 2021a). -A 1% rise in digital intensity corresponds to a substantial 2.9% increase in export earnings and a 0.1% uptick in the quality of exported goods (Chiappini & Gaglio, 2023).
Human capital and skills development	 -Human capital, particularly in the form of education and training, is a key driver of export performance (Gerdne, 2005; MULLIQI, 2016). -A firm-level study in Chile demonstrated that increased investment in training and skill development for employees raised the firm's export entry rate by 9.5 percentage points (Blyde 2016). -Skills development has a positive and significant impact on the per-capita value of high technology exports (Lall, 1999).

Source: Compiled from various sources.

⁸⁷ The study included a sample of 18 manufacturing and 14 service sectors in 40 countries over the period 2000–2014. digitalisation means that the production function of a sector in a country uses more digital inputs than in the past. Digitalisation entails either the inclusion of more technicians or computer scientists in the workforce or the use of (new) tools regardless of digital goods or services, such as computers or communication devices, in the portfolio of inputs.