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# PREFERENTIAL MARKET ACCESS UNDER EU GSP SCHEME AND BANGLADESH'S EXPORT SECTOR PERFORMANCE : EVIDENCE AND EMERGING ISSUES

## Introduction

Since the mid-1980s Bangladesh has moved, in successive phases, to liberalise her foreign trade regime. This change in policy thrust was realised on the ground by a shift from an inward looking and import substituting growth strategy to an outward looking and export oriented growth strategy, and was characterised by a general acceptance, at policy level, of the principles of deregulation, decontrol and liberalisation. The emphasis towards outward orientation of the economy gained momentum in recent years following important policy reforms carried out by Bangladesh under the Structural Adjustment Facilities and Extended Structural Facilities (SAF and ESAF) Programmes of Multilateral donors. The recent reforms have far reaching and important implications for future economic performance of Bangladesh, as these have exposed the country's economy to both the challenges as well as the opportunities of a fast changing global economy. An indicator of this increasing exposure is that the degree of openness of the economy has gone

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up from 21% in mid-eighties to almost 35% in FY 1996.[1] This would mean that Bangladesh's overall economic performance and growth rates will increasingly hinge on how her external sector actually performs. Evidently, the successful conclusion of the Uruguay Round Negotiations and the establishment of the World Trade Organisation (WTO) will have important implications for a more outward oriented and liberalised Bangladesh economy.

If the outward oriented reform in the economy is placed in relation to the external sector performance of Bangladesh, then it will be seen that the reforms have been quite successful in stimulating Bangladesh's export sector performance which was quite robust in recent years. Compound growth rate of exports was about 12% per annum over the last decade compared to the overall GDP growth rates of about 4% over the corresponding period. The high export growth rate was accompanied by significant structural shifts in exports demonstrated by shifts from primary to manufactured exports on the one hand, and from traditional to non-traditional exports on the other hand.[2] These structural changes were spearheaded by phenomenal growth of the exports of ready made garments (RMG) which constitute about two-thirds of Bangladesh's current exports.

The preferential market access enjoyed by Bangladeshi exports under the 16 GSP schemes has played a crucial role in stimulating the sector and achieving the aforementioned robust growth rates. The various GSP schemes provide Bangladesh, as a LDC, duty free access to the markets of the GSP donor countries,

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[1]Degree of openness indicates the share of exports plus imports as percentage of gross domestic product of a country.

[2]If in mid eighties the ratio between primary exports and manufactured exports was 34:66 at present this ratio stands at 15:85. There has also been similar shifts from traditional (raw jute, jute goods, tea) to non-traditional (RMG, shrimps, chemical products) exports from 64:36 to 13:87 over the matched period.

thereby allowing her exports competitive edge over both the domestic import-substituting competitors in the importing (GSP donor) countries, as well as competitors from other exporting countries who do not enjoy such preferential treatment. Through these incentives Bangladesh has been highly successful in accessing the markets of most of the developed countries which account for about four-fifths of her total exports.

Over the years, Bangladesh has been very successful in utilising the zero-tariff facilities extended under the EU GSP scheme. This is manifested in the fact that exports from EU has increased from 20.4% in FY 1985 to more than 40% in FY 1995. However, very recently, more stringent application of *EU rules of origin* has brought a sense of uncertainty in the export sector of Bangladesh. Duty free access to EU markets by one of the major exportables from Bangladesh, the knit-RMG, has come under serious threat because of this, which in all probability will have major impact on her future export sector performance. Sanctions have also been imposed for non-compliance with quality and environmental standards of set by the European Union. Bangladesh's export sector performance in near future will be critically dependent on how these emerging problems are resolved. This will also have serious implications in terms of her GDP growth rates, employment opportunities and poverty situation.

This paper focuses mainly on two areas - importance of EU GSP scheme for Bangladesh's current export sector performance and implications of some of the emerging GSP related issues in terms of the sector's future performance. The paper is divided into three sections. Section I briefly presents the direction of current reforms in Bangladesh's external sector and focuses on her export sector performance in recent years. Section II focuses on preferential treatment enjoyed by Bangladesh under EU GSP Scheme and its contribution to her export sector performance.

Section III concerns problems emerging with respect of accessing preferential treatment under the existing EU GSP Scheme and discusses some of the options from the Bangladesh perspective.

## Section I : Reforms in the External Sector and Export Sector Performance of Bangladesh in Recent Years

As mentioned in the introduction, Bangladesh has carried out important reforms in the recent past which has created a more liberalised trading regime in the country. The Reforms in the import sector included reductions and phase out of the quantitative restrictions (QRs), tariffication and significant reductions in the tariff levels. These reforms have substantially reduced both the nominal and the effective rates of protection (NRPs and ERPs) in the economy and, to a considerable degree, were effective in reducing the anti-export bias in the economy. Table 1 provides some idea about the level of tariff reductions in Bangladesh over the recent past. As can be seen from the table, even if we take into consideration only the last few years, average tariffs have comedown quite significantly : from 42% in FY 1990 to 17% in FY 1996.

### Table 1: Dynamics of Import Tariff Reduction in Bangladesh in the 1990s

| Import tariffs | FY 1990 | FY 1994 | FY 1995 | FY 1996 |
|---|---|---|---|---|
| Imp. wtd. average tariffs rates | 42% | 24% | 21% | 17% |
| Unweighted average tariff rates | 65% | 36% | 26% | 23% |
| Highest tariff rates | 400% | 300% | 60% | 50% |

Source : National Board of Revenue, Bangladesh

The number of quantitative restrictions, as can be seen from Table 2, has also been brought down quite substantially: from 315 in FY 1990 to 114 in FY 1995; only about 20% of these continue to remain on account of trade reasons (mainly textile imports). These reforms have reduced the ERPs significantly and created a more conducive and level playing field for export-oriented activities within the economy.

**Table 2 : Phased Removal of Quantitative Restriction**

| Fiscal Year Removal of QRs | FY 1990 | FY 1991 | FY 1994 | FY 1995 |
|---|---|---|---|---|
| **Total** | **315** | **239** | **109** | **114** |
| **Trade Reasons** | **253** | **179** | **40** | **23** |
| (a) Banned | 135 | 93 | 7 | 5 |
| (b) Restricted | 66 | 47 | 19 | 6 |
| (c) Mixed | 52 | 39 | 14 | 12 |
| **Non-Trade Reasons** | **62** | **60** | **69** | **92** |

Source: Experiences with Economic Reform: Review of Bangladesh's Development, 1995.

On the exports side, the bonded warehouse facilities for RMG exports, duty drawback facilities, cash compensation schemes and other fiscal, financial and institutional incentives have been quite successful in enhancing the sector's performance in the recent past. Incentives provided through the domestic policies also received effective support from major developed countries which provided preferential treatment to Bangladeshi exports through their respective GSP schemes. Bangladesh is the beneficiary of 16 GSP schemes of which the EU GSP scheme is the most important in terms of export share. Over the last decade, the domestic incentive schemes and external (importing country) preferential market access had been translated into relatively robust export sector performance and export sector growth in Bangladesh.

The data presented in Table 3 are a pointer to the dynamics of the export sector and the export structure of Bangladesh over the

**Table - 3: Structure of Exports from Bangladesh: FY 1985 - FY 1996**

| Earnings / Exports | FY 1985 | | FY 1990 | | FY 1995 | | FY 1996 | |
|---|---|---|---|---|---|---|---|---|
| | Total | As % of Total | Total | As % of Total | Total | As % of Total | Total | As % of Total |
| Raw Jute | 150.8 | 16.1 | 124.6 | 8.2 | 79.5 | 2.3 | 90.7 | 2.3 |
| Tea | 61.0 | 6.5 | 39.3 | 2.6 | 32.8 | 0.9 | 33.1 | 0.8 |
| Frozen Food | 86.8 | 9.3 | 138.1 | 9.0 | 305.6 | 8.8 | 313.7 | 8.1 |
| **Primary Commodities** | **316.6** | **33.8** | **322.9** | **21.2** | **452.2** | **13.0** | **475.8** | **12.2** |
| Jute Goods | 389.8 | 41.7 | 331.3 | 21.7 | 318.8 | 9.2 | 328.9 | 8.5 |
| Leather | 69.8 | 7.5 | 178.9 | 11.7 | 202.1 | 5.8 | 211.7 | 5.5 |
| Chemical Products | 116.2 | 12.4 | 22.8 | 1.5 | 107.6 | 3.1 | 98.5 | 2.5 |
| Woven RMG | 6.5 | 0.7 | 609.3 | 40.0 | 1835.1 | 52.8 | 1948.8 | 50.2 |
| Knit RMG | | | 14.8 | 0.9 | 393.3 | 11.3 | 598.3 | 15.4 |
| **Manufacturing Commodities** | **617.8** | **66.2** | **1200.7** | **78.8** | **3020.4** | **87.0** | **3406.6** | **87.8** |
| **Total Exports** | **934.4** | **100.0** | **1523.7** | **100.0** | **3472.6** | **100.0** | **3882.4** | **100.0** |
| Growth over previous year | 15.2% | | 17.8% | | 37.0% | | 11.8% | |

Source: Export Promotion Bureau of Bangladesh.

last decade. Exports grew at a compound rate of 13.8% between FY 1985 and FY 1996 and by 17.7% between FY 1991 and FY 1996. As Table 3 shows, this growth was accompanied by a quite remarkable shift in the structure of Bangladeshi exports from a jute-centric one to a RMG centric one. Importance of traditional exports like raw jute, tea and jute goods were substantially reduced as increasingly large part of incremental exports was being accounted for by non-traditional exports such as woven, and subsequently knit RMG and frozen food export. Bangladesh is one of the very few LDCs whose major share of export earnings is accounted for by manufactured exports (about 88% of total exports in FY 1996). This shift is clearly borne out by Table 4. The ratio between export earnings from primary and manufactured exports changed from 34:66 in FY 1985 to 12:88 in FY 1996, while the corresponding shares of traditional and non-traditional exports changed from 64:36 to 11:89 over the same period.

These significant structural changes were mainly brought about by very high growth rates of the RMG exports in recent years. The first wave of increase in RMG exports came in the wake of shifts in RMG production from countries like Taiwan and S. Korea to Bangladesh as the export quota of these countries approached limits set under the multifibre agreement (MFA). Bangladeshi entrepreneurs were quick to grasp this opportunity, firstly through joint-ventures with the Koreans, and then on their own. Exports of RMG amounted to $ 116 million in FY 1985, and went on to reach $ 609 million in FY 1990 and $ 1.95 billion in FY 1996, a sixteen fold increase within 10 years. In case of the knit-RMG export which was virtually absent in FY 1985 and only about $ 15 million in FY 1990, exports had reached $ 598 million by FY 1996. Knit and woven RMG together now account for 65% of total exports from Bangladesh.

**Table 4: Shifts in Bangladesh Export Structure**

(in percentage)

| Structure of Exports | FY 1985 | FY 1990 | FY 1996 |
|---|---|---|---|
| Primary Commodities | 34.0 | 21.0 | 12.0 |
| Manufactured Commodities | 66.0 | 79.0 | 88.0 |
| **Total Exports (million USD)** | **100.0 (934.4)** | **100.0 (1523.7)** | **100.0 (3882.4)** |
| Traditional Exports | 64.0 | 32.0 | 11.0 |
| Non-traditional Exports | 36.0 | 68.0 | 89.0 |

Source : Independent Review of Bangladesh's Development 1995 and Export Promotion Bureau, 1996.

Thus, it will not be an exaggeration to say that any disruption in the market access of RMG exports will have serious consequence in terms of not only the export sector performance but also the country's overall economic performance, debt service liability[3] and employment, specially female employment.[4] It is from this vantage point that the EU GSP scheme's implications for Bangladesh are discussed in the next two sections - firstly, to define the role and the importance of EU GSP scheme in terms of Bangladesh's export sector performance and secondly, to assess the impact of the recent EU decision regarding sanctions against

[3]Bangladesh has been able to limit her debt-service liability within 15% of her export earnings.

[4]Most of the 850 thousand workers in about 2500 RMG factories are women. It is the single largest in terms of female employment sector in Bangladesh.

Bangladesh which would limit preferential treatment of certain commodities currently enjoyed by her and which may have serious negative consequence in terms of Bangladesh's export performance in the very near future.

## Section II: Preferential Treatment Under EU GSP and Its Importance for Bangladesh's Export Sector Performance.

Preferential treatment under the various GSP schemes had played an important role in terms of stimulating the growth of Bangladesh's export sector in recent years. Bangladesh enjoys duty free access under 16 GSP schemes provided by the developed countries. These GSP donor countries accounted for 82% of the total exports from Bangladesh in FY 1996, compared to the 60% in FY 1985. Table 5 shows the relative position of EU amongst the GSP donor countries. Between FY 1985 and FY 1996 the share of EU in total exports from Bangladesh increased from 20.4% to 40.1%. As Table 6 shows, the share of imports from EU has not changed much in the last decade stagnating at about 12%. The robust export sector performance has meant that Bangladesh was able to maintain a positive balance of payments with EU. The balance in the trade sector has steadily increased in the 1990s - if in FY 1990 the balance was (-)$76 million, then in FY 1994 it stood at (+)$530 million, while by FY 1995 it had reached (+)$725 million. A close look at Tables 5 and 6 shows that U.S.A. and EU are the two most important export markets of Bangladesh - in FY 1995 these two contributed about three-fourths of total export earnings of Bangladesh (Table 5). As Table 7 shows, amongst the EU countries, Bangladesh's major export destinations are the U.K. (22.8% of EU imports from Bangladesh), Germany (11.5%) and France (13.9%).

**Table 5: Exports of Bangladesh to countries which provide Bangladesh Preferential Access under GSP schemes**

(million USD)

| Countries | 1984-85 | | 1993-94 | | 1994-95 | |
|---|---|---|---|---|---|---|
| | Export | Share in Total Export | Export | Share in Total Export | Export | Share in Total Export |
| U.S.A | 165.9 | 17.8% | 734.82 | 29.00% | 1184.28 | 34.10% |
| E.U | 190.6 | 20.4% | 1139.09 | 44.95% | 1393.89 | 40.14% |
| Japan | 65.3 | 7.0% | 61.02 | 2.41% | 99.65 | 2.87% |
| Canada | 12.1 | 1.3% | 57.23 | 2.26% | 89.38 | 2.00% |
| Russia | 38.0 | 4.0% | 30.26 | 1.19% | 31.32 | 0.90% |
| Australia | 15.3 | 1.6% | 21.35 | 0.84% | 16.50 | 0.47% |
| Austria | - | - | 6.60 | 0.26% | 2.50 | 0.07% |
| Finland | - | - | 2.40 | 0.10% | 5.75 | 0.16% |
| New Zealand | 2.3 | 0.2% | 0.96 | 0.04% | 2.45 | 0.07% |
| Norway | - | - | 8.96 | 0.35% | 13.61 | 0.39% |
| Poland | 9.9 | 1.1% | 14.63 | 0.58% | 8.05 | 0.23% |
| Sweden | 2.5 | 0.3% | 14.63 | 0.58% | 24.89 | 0.72% |
| Switzerland | 10.1 | 1.1% | 5.24 | 0.21% | 10.49 | 0.30% |
| Hungary | 0.4 | - | 0.1 | - | 0.3 | - |
| Bulgaria | 43.9 | 4.7% | 0.9 | - | 0.1 | - |
| Czechoslovakia | 1.5 | - | - | - | - | - |
| Total | 556.0 | 59.5% | 2097.19 | 82.97% | 2882.76 | 82.42% |

Source: Compiled from Export Promotion Bureau.

**Table 6: Dynamics of EC-Bangladesh Balance of Payments Position**

(in mln. USD)

| | FY 1988 | FY 1990 | FY 1991 | FY 1992 | FY 1993 | FY 1994 | FY 1995 | FY 1996 |
|---|---|---|---|---|---|---|---|---|
| Exports to EC | 368 | 502 | 676 | 735 | 880 | 1087 | 1397 | 1633 |
| (Share in total exports) | (28.5%) | (30.0%) | (40.2%) | (36.0%) | (36.8%) | (44.9%) | (40.1%) | (42.1%) |
| Imports from EC | 354 | 578 | 429 | 435 | 489 | 557 | 672 | - |
| (Share in total imports) | (11.7%) | (15.8%) | (12.5%) | (11.7%) | (12.2%) | (11.4%) | (11.9%) | - |
| Balance of Payments | | | | | | | | |
| (Surplus +, Deficit -) | 14 | -76 | 247 | 300 | 391 | 530 | 725 | - |
| Memo Item: | | | | | | | | |
| USA: Exports | 336 | 510 | 449 | 734 | 765 | 930 | 1491 | 1433 |
| Imports | 182 | 186 | 176 | 258 | 174 | 257 | 340 | - |

Source: Export Promotion Bureau, Bangladesh.

The structure of exports to EU on the other hand, shows that exports are heavily concentrated in the RMG sectors with woven and knit RMG exports accounting for more than three-fifths of EU imports from Bangladesh. Leather and shrimp are the other major exports to EU markets.

It is relevant here to analyse the role of EU GSP in stimulating exports from Bangladesh to EU member countries. EC took an important initiative in favour of developing countries when its GSP scheme was put in place in July 1971. EC-Bangladesh Commercial agreement was signed in 1976. Till 1986 trade between EC and Bangladesh took place on the basis of letter of exchange. In 1986 EC-Bangladesh textile agreement was signed. As is known exports of RMG in U.S. market is regulated by quotas under the MFA, and shrimp is not allowed duty free treatment under the U.S. GSP scheme. Under the circumstances the EU GSP scheme has turned out to be by far the most important GSP scheme for Bangladesh. Currently the EU allows duty free and unlimited access to all Bangladeshi exports commodities in the H.S. categories 1-24 (agricultural goods), 25-49 and 64-97 (industrial goods) and 50-63 (textile products). A look at the structure of exports provided in Tables 3-6 would indicate that virtually all exports from Bangladesh are covered under these broad categories. This makes EU GSP's coverage the most extensive one enjoyed by Bangladesh.

**Table 7: Bangladesh's Exports to EU Countries in FY 1995**

| EU Countries | 1994 - 95 | | |
|---|---|---|---|
| | Value (mln. USD) | % Share of Exports to EU | % Share of Exports to all Countries |
| Belgium | 126.6 | 9.2 | 3.7 |
| Denmark | 39.2 | 2.8 | 1.1 |
| France | 192.9 | 13.8 | 5.6 |
| Germany | 300.3 | 21.5 | 8.7 |
| Greece | 6.3 | 0.5 | 0.2 |
| Ireland | 4.2 | 0.3 | 0.1 |
| Italy | 211.3 | 15.2 | 6.1 |
| Luxembourg | - | - | - |
| Netherlands | 136.7 | 9.8 | 3.9 |
| Portugal | 3.0 | 0.2 | 0.1 |
| Spain | 53.2 | 3.8 | 1.5 |
| U.K. | 318.3 | 22.8 | 9.2 |
| Total E.U. | 1393.9 | 100.0 | 40.1 |
| Total of All Countries | 3472.6 | | |

Source : Export Promotion Bureau.

## Table 8 : Exports to EU from Bangladesh by Major Chapters

| Products | Value in million USD | Total Export to EU |
|---|---|---|
| Articles of apparel and clothing (not knitted or crocheted) | 671.3 | 48.1% |
| Articles of apparel and Clothing (knitted or crocheted) | 400.9 | 28.7% |
| Fish and other aquatic invertebrates | 103.5 | 7.4% |
| Vegetable text. fibers (incl. jute) | 69.3 | 4.9% |
| Hides and Skin and Leather | 70.3 | 5.0% |
| Other made up Textile Articles | 22.8 | 1.6% |
| All other Products | 58.8 | 4.2% |
| **Total Exports to EU** | **1397.0** | **100.0%** |

Source : EUROSTAT Bulletin, 1997.

It needs to be pointed out here that preferential treatment can vary from item to item under the different GSP schemes and, within a certain product group, some sub-products may be eligible for tariff reduction while others may not. There are also specific features of various GSP schemes depending on the rules specified by a particular donor country. For example, under certain GSP schemes e.g. the EU GSP Scheme, tariff quotas and ceilings are set up for specified commodity groups so that a number of listed imports are charged at normal rates of duty. It is to be noted in this context that under existing EU GSP Scheme, Bangladesh is exempted from such limitations as a least developed country, which otherwise significantly limit access under GSP facilities in case of many developing countries.

An important precondition which is to be fulfilled for accessing GSP preferential treatment is the so called *rule of origin* whose terms of reference may vary from scheme to scheme. As

GSP is originally mandated to encourage trade related backward linkage by way of enhancing manufacturing activity in recipient countries, rule of origin ensures that benefits are accrued to goods which are actually manufactured by the developing countries themselves, and do not in reality originate in a developed country from which it is imported by GSP recipient countries. For GSP eligibility exported goods may have : (a) 100 p.c. value addition in the recipient country or/and (b) value addition may be less than 100 p.c. through (i) manufacturing of whole; or (ii) part of the product from materials and parts imported into the country. As a matter of fact, in case of (a) the GSP scheme is fully operative without any condition. However, in case of (b) there are two criteria for eligibility : (1) the *Process Criterion* (applied by the EC, Japan, Austria, Finland, Norway and Switzerland) whereby commodities are eligible for GSP facilities, if and only if, these are sufficiently transformed; the latter being defined as having passed the manufacturing stage to such extent that the resultant product is classified in a different four-digit H.S. Code as distinct from the H.S. code of non-originating materials which went into producing the end-product; (2) *Value added criterion* (applied by the U.S., Canada, Australia and East European countries) whereby eligibility under GSP is measured on the basis of transformation defined by value addition criterion as distinct from the degree and type of processing (which is used when the process criterion is applied). A clear understanding of the rules of origin requirement is essential to fully evaluate some of the emerging problems in EU-Bangladesh trade relationship in recent years.

At the initial stage EU GSP was not very important for Bangladesh because of the prevailing structure of Bangladesh's exports which was dominated by primary commodities. As was pointed out, the EU GSP is built on process criterion and transformation of products (at 4 digit H.S. Code), which would mean eligibility for preferential treatment only for manufactured

## Table 9: Share of Exports of Selected Commodities to EU and US Markets

(in mln. USD)

| Commodity | FY 1991 | FY 1992 | FY 1993 | FY 1994 | FY 1995 |
|---|---|---|---|---|---|
| **Woven - RMG** | | | | | |
| Total Exports | 735.6 | 1064.0 | 1240.5 | 1291.6 | 1835.1 |
| Share of EU | 42.0% | 42.0% | 40.0% | 49.5% | 43.6% |
| Share of USA | 50.0% | 52.0% | 53.0% | 42.0% | 49.5% |
| **Knit - RMG** | | | | | |
| Total Exports | 131.2 | 118.6 | 204.5 | 264.2 | 393.3 |
| Share of EU | 69.0% | 70.0% | 43.0% | 47.0% | 66.3% |
| Share of USA | 25.0% | 23.0% | 38.0% | 32.0% | 24.9% |
| **Jute Goods** | | | | | |
| Total Exports | 290.3 | 301.6 | 292.4 | 283.8 | 318.8 |
| Share of EU | 20.0% | 13.0% | 10.0% | 12.0% | 10.0% |
| Share of USA | 11.0% | 6.0% | 4.0% | 8.0% | 6.0% |
| **Frozen Fish and Shrimp** | | | | | |
| Total Exports | 141.8 | 130.5 | 165.3 | 210.5 | 305.6 |
| Share of EU | 51.0% | 43.0% | 44.0% | 47.0% | 41.5% |
| Share of USA | 32.0% | 37.0% | 38.0% | 33.0% | 27.5% |
| **Leather and Leather** | | | | | |
| **Products** | 134.3 | 144.5 | 147.9 | 168.2 | 202.1 |
| Total Exports | 54.0% | 45.0% | 36.0% | 39.0% | 37.0% |
| Share of EU | | | | | |
| **All Commodities: Total** | **1717.5** | **1993.9** | **2382.9** | **2533.9** | **3472.6** |
| Share of EU | 39.0% | 38.7% | 36.8% | 44.9% | 40.1% |
| Share of USA | 29.5% | 33.8% | 34.5% | 28.9% | 28.8% |

Note: U.S. Market Share in Bangladesh's Leather Exports is insignificant.

Source: Computed from EPB data.

and semi-manufactured products. It has been roughly estimated that in the late 1970s only about 12% of exports from Bangladesh to EC countries enjoyed GSP facilities (Chowdhury, N, 1994). Gradually, as the structure of exports changed and the manufacturing base broadened (mainly through of RMG and shrimp exports) EU GSP attained increasing importance for Bangladesh. EU's growing importance is vividly borne out by Table 9 which shows European Union's share in the exports of some of the most important export commodities from Bangladesh. Commodity-wise EU is very important in terms of such major non-traditional exports from Bangladesh as woven-RMG (44% of total exports), knit-RMG (66%), frozen fish and shrimp (42%) and leather and leather products (37%) which together account for about 85% of Bangladesh's exports.

Reduction of tariffs agreed during Uruguay Round negotiations would mean that preferential margins enjoyed under EU GSP Schemes would be substantially reduced. However, it is to be noted that these reductions are relatively low for items of special export interest to Bangladesh. Thus, as Table 10 shows, although following the Urguay Round average EU most favoured

**Table 10: Uruguay Round Reductions in Tariffs by EU of Selected Groups of Commodities Having Export Importance for Bangladesh**

| | MFN Tariff Averages | | |
|---|---|---|---|
| | Pre-UR | Post-UR | Reduction |
| **All Sectors** | **9.8** | **6.9** | **29.8%** |
| Textile and Clothing | 11.9 | 10.1 | 14.9% |
| Leather and Footwear | 9.1 | 7.8 | 14.7% |
| Tropical Agri-products | 17.4 | 10.0 | 42.6% |

Source: UNCTAD Statistical Yearbook, 1995.

nation (MFN) rates would come down from 9.8% to 6.9%, indicating a reduction of almost 30%, reduction in case of textile commodities will be only 14.9% and in case of leather 14.7%. The level of tariffs will also be higher than the average post-UR tariff rates of 6.9% : in case of textiles the post-UR tariff rates is 10.1%, and for leather and agri-products it is 10.1% and 10.0% respectively. Thus, the margins to be accrued from preferential treatment under EU GSP schemes in the form of zero-rate access to EU markets of these commodities is still considerably high inspite of reductions in MFN tariff rates. We have pointed out earlier (Table 5) that EU's share in total exports of Bangladesh was only 20.4% in 1985 (prior to the signing of the agreement on textiles with EU). Following the textile agreement the share of EU in the total exports of Bangladesh has been steadily rising; this share stood at 40.1% in FY 1995. Of the five main categories of exports to EU shown in table 9 excepting woven RMG all the others enjoy preferential treatment under EU GSP. Woven RMG is eligible to enjoy preferential treatment in EU market if it can satisfy two stage- transformation under the process criterion (from yarn to fabrics and from fabrics to RMG). Bangladesh is mainly dependent on imported fabrics under back to back L/Cs; hence the amount of exports of woven-RMG under GSP preferential treatment to EU is not significant. On the other hand, in case of knit-RMG EU process criterion requires three-stage transformation; from fibre to yarn, yarn to fabrics and fabrics to knit-apparels. Bangladesh has been enjoying EU GSP facilities in case of exports of knit-RMG since the late 1980s. In fact preferential access to EU markets has been a critical factor in the expansion of knit-RMG exports from Bangladesh. As duty on knit-RMG products in the EU market is about 12.5% the GSP provides substantial competitive edge to Bangladeshi exports over some of the other sources.

## Table 11: Exports of Bangladesh Under GSP Schemes

(Million USD)

| Commodity | Financial Year | Total Exports | Total Exports Under all GSP Schemes | Exports under EU GSP | Share of Exports under EC GSP in Total Exports Under GSP |
|---|---|---|---|---|---|
| Jute Goods | 1992-93 | 292.4 | 79.2 | 29.2 | 36% |
| | 1993-94 | 283.8 | 79.2 | 34.1 | 43% |
| | 1994-95 | 318.8 | 94.3 | 31.9 | 34% |
| Leather | 1992-93 | 147.9 | 129.4 | 53.2 | 41% |
| | 1993-94 | 168.2 | 159.0 | 65.6 | 41% |
| | 1994-95 | 202.1 | 189.7 | 74.8 | 39% |
| Shrimps and Prawn | 1992-93 | 155.5 | 100.5 | 67.9 | 68% |
| | 1993-94 | 197.7 | 111.9 | 96.1 | 86% |
| | 1994-95 | 260.7 | 127.4 | 108.1 | 85% |
| Frozen Fish | 1992-93 | 9.9 | 9.5 | 3.6 | 38% |
| | 1993-94 | 12.8 | 11.4 | 3.8 | 33% |
| | 1994-95 | 44.9 | 40.3 | 13.3 | 33% |
| Handicrafts | 1992-93 | 5.4 | 4.9 | 3.4 | 69% |
| | 1993-94 | 7.3 | 6.8 | 4.7 | 69% |
| | 1994-95 | 6.5 | 6.2 | 3.7 | 60% |
| Ceramic Goods | 1992-93 | 5.6 | 5.9 | 3.3 | 56% |
| | 1993-94 | 9.1 | 8.7 | 4.4 | 51% |
| | 1994-95 | 8.5 | 6.8 | 3.4 | 50% |
| Woven-RMG | 1992-93 | 1240.5 | - | - | - |
| | 1993-94 | 1291.6 | - | - | - |
| | 1994-95 | 1835.1 | - | - | - |
| Knit-RMG | 1992-93 | 204.5 | 203.8 | 87.9 | 44% |
| | 1993-94 | 264.2 | 241.2 | 124.2 | 47% |
| | 1994-95 | 393.3 | 370.3 | 260.8 | 71% |
| Total | 1992-93 | 2382.9 | 565.2 | 424.0 | 75% |
| | 1993-94 | 2533.9 | 671.6 | 497.0 | 74% |
| | 1994-95 | 3472.6 | 878.3 | 596.0 | 68% |

Source: Computed from Export Promotion Bureau Data.

We have presented some indications about the relative importance of the GSP Scheme run by EU in Table 11. It is clear from the table that EU GSP is the most important one for Bangladesh. In recent years the share of EU GSP has averaged about 70% of total exports under all GSP programmes. In FY 1995 about $ 878.0 million worth of exports enjoyed preferential market access under the various GSP schemes. This would mean that about a fourth of Bangladesh's total exports enjoyed preferential access under the various GSP scheme. In the same year total exports under EU GSP amounted to $596.0 million which was equivalent to 68% of global exports under GSP. Exports under EU GSP was 42% of total exports to EU countries which is much higher than the average figure for all exports (i.e. 25%) (Table 12). Exports under Non-EU GSP facilities as a percentage of total non-EU exports was only about 14% which also reemphasises the importance of EU GSP scheme for Bangladesh.

**Table 12 : Importance of EU GSP Scheme for Bangladesh's Export Sector (FY 1995)**

| Indicator | Magnitude/Share |
|---|---|
| Total Exports Under GSP | $ 878.3 million |
| Exports Under EU GSP | $ 596.0 million |
| Exports Under GSP as % of Global Exports from Bangladesh | 25.3% |
| Exports Under GSP as % of Global Exports to GSP Donor Countries | 30.5% |
| Exports Under EU GSP as % of Global Exports to EU Countries | 42.8% |
| Exports Under Non-EU GSP as % of Global Exports to Non-EU GSP Donor Countries | 18.9% |
| Exports Under Non-EU GSP as % of Global Exports to Non-EU Countries | 13.6% |

Source : Computed from Tables 5,9,11 of this paper.

As is indicated by the structure of EU GSP, major export commodities from Bangladesh enjoying preferential market access to the European Union are knit-RMG, jute goods, shrimps and frozen fish and leather goods (Table 11). Bangladesh has been enjoying preferential market access in the exports of these commodities for quite a number of years. Barring export of readymade garments, compliance with EU process criterion does not pose difficulty for Bangladesh as most of her exports are manufactured or semi-manufactured items from local raw-materials. Bangladesh is not eligible for preferential access in case of woven-RMG goods because most of the fabrics are imported to Bangladesh under back to back L/C, so that woven-RMG can not comply with the two-stage conversion, criteria necessary for accessing EU GSP. On the contrary, till now, Bangladeshi knit-RMG products had been enjoying preferential access to EU. As was mentioned earlier in case of knit-RMG a three-stage conversion is required. It is in case of knit-RMG that, of late, serious uncertainty has appeared regarding continuance of preferential treatment under EU GSP scheme. Complaints had been lodged that Bangladesh is enjoying EU GSP facilities inspite of not having fulfilled the 3-stage conversion criterion. The threat of discontinuation of EU GSP facility from Bangladeshi knit-RMG products is a very serious one; it is fraught with far reaching implications for future export sector performance of the country.

The importance of knit-RMG is borne out by the fact that in recent years about 47% of incremental exports from Bangladesh are accounted for by the knit-RMG exports (Table 13). Bangladesh's future export performance will, to a considerable degree, depend on how this sector performs in future and any disruption in market access will have serious negative consequence for overall performance of the economy. As we have seen from Table 9, EC's share in knit-RMG has been increasing steadily over the last few years and has reached 66.3% in FY 1995. This is a pointer to the growing importance of EU market for knit-RMG exports of Bangladesh. The current debate regarding the process criterion as applicable to knit-RMG, thus, is of crucial importance to Bangladesh. This issue will be dealt with in some detail in the next section.

**Table 13: Structure of Incremental Exports from Bangladesh in the 1990s**

(in percentage)

| Items | FY 1993 | FY 1994 | FY 1995 | FY 1996 | FY 1997 (July-Feb) |
|---|---|---|---|---|---|
| Raw Jute | -2.9 | -11.5 | 2.4 | 2.7 | 7.8 |
| Tea | 2.2 | -1.9 | -0.6 | -0.7 | 1.7 |
| Frozen Food | 8.9 | 29.9 | 10.1 | 1.2 | 4.3 |
| **Primary Commodities** | **11.8** | **21.8** | **11.2** | **5.8** | **17.3** |
| Jute Goods | -2.4 | -5.7 | 3.7 | 2.5 | 1.7 |
| Leather | 0.9 | 13.4 | 3.6 | 2.3 | -6.9 |
| RMG | 45.4 | 33.9 | 59.8 | 23.4 | 25.0 |
| Knit Wear | 22.1 | 39.5 | 13.8 | 50.0 | 47.4 |
| Chemical Products | 7.7 | -0.7 | 5.7 | -2.1 | 0.1 |
| **All Manufacturing Commodities** | **88.2** | **78.3** | **88.8** | **94.2** | **82.7** |
| **Total Exports (in mln $)** | **100.0 (389.0)** | **100.0 (151.0)** | **100.0 (938.7)** | **100.00 (409.8)** | **100.0 (232.0)** |

Source: Computed from EPB data

## Section III: Market Access Under EU GSP and the Emerging Problems

We have seen in the previous section that EU GSP has become an important factor of continued robust export sector performance of Bangladesh. However, in recent years some serious problems have arisen which have put question mark on the continued preferential access to EU markets by Bangladeshi exports. As we have mentioned above, objections have been raised against Bangladesh's star export performer, the Knit-RMG on grounds of non-compliance with EU process criterion. As knit-RMG products do not undergo three-stage conversion. i.e. fibre to yarn, yarn to knit-fabrics and knit-fabrics to knit-RMG, EU has threatened that it may discontinue preferential market access of knit-RMG from Bangladesh on the ground of non-compliance with rules of origin provisions of EU GSP scheme.

Major exportables from Bangladesh like shrimp, jute goods, leather, ceramic wares, vegetables etc. conform to EU process criterion and hence these commodities have, till now, continued to enjoy preferential market access.[5] But even as early as 1993, EC had warned Bangladesh that she must undertake certain corrective steps in order to raise the processing standard of some of the frozen food products which are exported from Bangladesh.

Very recently, EC has informed Bangladesh that it will ban imports of shrimps and frozen foods from Bangladesh as the country has failed to comply with the existing EC health standards.[6] This is a serious threat to Bangladesh as the frozen

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[5]EC had raised objection to export of shrimps from Bangladesh on the ground of non-compliance with EU environmental standards. It had informed Bangladesh that it will discontinue imports of shrimp if certain standards are not maintained - e.g. use of fresh water in the processing stage; use of turtle-extrude machines during capture of shrimp. EC has raised environmental issues as regards leather sector of Bangladesh as well.

[6]In fact EC has been raising questions about health standards since 1993. The two member EC mission that visited Bangladesh in February, 1995 mainly visited the government infrastructures. They recommended increase of manpower in relevant bodies and asked for more control over

food and shrimp exports has been registering quite robust growth in recent time. In FY 1997 the sector earned more than $300 million (about 8% of total exports) out of which EC's share was about 60%. Following requests from the Bangladeshi authorities EC has agreed to extend the August 15, 1997 deadline by a month to allow export of pre-ban consignments. EC has informed Bangladesh that it would give a fresh opportunity to export frozen fish only after the EC delegation scheduled to visit Bangladesh in November 1997 certifies that the shrimp processing plants in the country are maintaining the required standard and hygienic conditions.[7] As a reactive measure GOB has now set up a *task force* to prepare a manual (*check list*) which the frozen food processing plants would need to comply with in future. The *task force* would investigate whether the processing units are adhering to the standards set in the manual and will send a new list of frozen foods processing units to EC by 31 October 1997. EC has informed Bangladesh that it will review the decision on ban before 30 November, 1997.[8]

The analysis in section II provides an idea about the growing importance of the knit-RMG exports for Bangladesh. Its share in total exports has gone up from 1% in FY 1990 to more than 15% in FY 1996 (Table 3). What is more important, in recent years the

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exporting firms. The two member EC mission that visited Bangladesh in June, 1997 (between 23-27 June, 1997) visited 6 frozen food processing factories. The sanctions have now been imposed following the visit by this mission.

A matter of added concern is that the EC ban may also prompt other major importers of Bangladesh's frozen foods like U.S.A. and Japan who would be induced to impose their own sanctions.

Three committees have been set up under the *task force* to look at (a) the infrastructure, (b) the existing facilities and (c) the actions that need to be undertaken in the light of EC health standards and recommendations made by the EC mission. The committees have been given 15 days to submit their reports to the Ministry of Fisheries.

share of knit-RMG in the incremental exports has been going up very fast: in FY 1996 this share was 50% which would imply that further export sector growth now critically hinges on the performance of knit-RMG exports. It has also been shown that about two-thirds of these exports go to EU markets. This would mean that any disruption in the EU market would seriously jeopardise the knit-RMG exports of Bangladesh and hence her overall export sector performance. If we take into consideration that hundreds of thousands of workers, mostly female workers, are employed in this sector, then any such disruption may have serious implications in terms of female employment and urban poverty situation in Bangladesh.

We have pointed out earlier that tariffs on textiles and apparels continue to remain relatively high - the pre UR MFN rates were 11.9% which have now been brought down to about 10.1% (a reduction of 14.9% compared to general reduction of 29.8%). In fact, in case of knit-RMG the tariffs average 12.5% in EU market. Zero tariff access means that the European garments importers get a substantial edge in price competitiveness if they import the products from Bangladesh. Over the years this has allowed Bangladesh to carve out its own market niche in the EU countries. In fact, Bangladesh has become the foremost exporter of items like T-shirts to EU. As can be seen from Table 14, Bangladesh's export of this item was 17.7% of total EU imports; market share of India and Pakistan, on the contrary, were only 6.9% and 2.4% respectively. Bangladesh's overall market share in some of the main RMG items, which stood at 6.2% in 1995, was also much higher than Pakistan, and not much below India, countries which are two of world's premier textile powers.

**Table 14: Exports of Selected RMG Products from Bangladesh, India and Pakistan to EC (Jan-Sep. 1995)**

| Commodities | Total Extra-EC Imports (Numbers in Million) | Share of Selected Countries in Total EC Imports | | |
|---|---|---|---|---|
| | | Bangladesh | India | Pakistan |
| T-Shirt (H.S. 6109) | 800.3 (100.00%) | 17.70% | 6.94% | 2.37% |
| Jerseys, Pullovers (H.S. 6110) | 304.8 (100.00%) | 5.19% | 5.68% | 1.09% |
| Trousers (H.S. 6203 and 6204) | 350.7 (100.00%) | 4.53% | 2.03% | 4.60% |
| Blouses Shirts (H.S. 6106 and 6206) | 349.5 (100.00%) | 3.64% | 41.74% | 0.94% |
| Woven Shirt (H.S. 6205) | 357.6 (100.00%) | 36.27% | 11.92% | 1.19% |
| Total (in units) | 2,162.9 (100.00%) | 14.60% | 12.41% | 2.12% |
| **Total (in mln USD) : 1995 (Jan-Sep)** | **11,682.6** | **6.18%** | **6.95%** | **1.30%** |
| **: 1994 (Jan-Dec)** | **14,231.4** | **5.62%** | **5.35%** | **1.20%** |
| **: 1993 (Jan-Dec)** | **13,769.5** | **4.70%** | **5.35%** | **1.19%** |

Source: EUROSTAT Internal and External Trade of the EU; 1993-95.

It needs to be acknowledged that the allegations of violation of rules of origin brought against Bangladesh are not without foundation. Under EU regulations the Export Promotion Bureau (EPB) of Bangladesh is supposed to issue certificates of origin confirming that the knit-RMG exports to EU were made up of yarn which has been locally produced.[9] Bangladesh has some capacity in the spinning sector but this can meet only about 5% of the total demand of export oriented knit-RMG sector. In the past the EPB has overlooked the origin of yarn and issued the certificates when a *chalan* (receipt) was submitted by the exporter testifying that the yarn was bought locally. However, the fact of the matter was that the overwhelming number of *certificates of origin (CO)* were obtained on the basis of false chalans, because most of the yarn originated in India from where it was either imported or smuggled to the domestic market. The EPB issued the certificate on the ground that the exporter has submitted documents testifying that he has bought the yarn locally. The exporters passed over these COs to the European importers who, on submission of these certificates, ensured that they got duty-free entry for these Bangladeshi knit-RMG products to European markets. The amount of duty waived, as was pointed out, is substantial, and helped these importers remain competitive both against importers from countries not enjoying EU GSP facilities as well as against competitors from domestic import substituting industries. This made Bangladesh knit-RMG products very attractive to EU importers.

However, as late as in 1992, the EC commission launched an investigation to check conformity with the EU rules of origin criteria. EU GSP facility was cancelled for knit-RMG exports from such LDCs as Maldives, Nepal, Cambodia and Laos, countries which in fact did not have any indigenous spinning capacity and had been traditionally benefitting from EC's lenient attitude. No step was taken against Bangladesh at that time, but following complaints lodged by these countries and other

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[9]This provision was put in place to ensure that the benefits don't go to third countries (which are not LDCs) and in order to encourage backward linkage in the LDCs.

interested quarters EC launched a major investigation in 1995 to settle the matter once and for all. The EC investigation team embarked on checking, jointly with the Bangladesh authority, the validity of certificates of origin issued by EPB from 1993 onwards (i.e. certificates issued during previous two years). About 25 thousand COs were earmarked for checking. The Commission has categorised the findings in three groups. Schedule A, Schedule B and Schedule C. Schedule A contains 367 certificates of Origin which it had found to be fictitious. Schedule B contains about 6910 certificates which EC claims to have been wrongly issued by EPB. Schedule C contains about 8562 certificates which it suspects to be fake and has asked EPB to investigate and report within 6 months.[10]

The EC has now asked EPB to cancel the 6910 certificates it had found to be false and has imposed fines on EU importers who received preferential treatment under EU GSP on the basis of these COs.[11] Any further issuance of COs by EPB will now be strictly on the basis of *inland back-to-back L/Cs* and (*not chalans*). As of 23 January 1997, the EPB has strictly started implementing this instruction. This would mean that a substantial portion of Knit-RMG exports from Bangladesh will no more be eligible for EU GSP. Already, many EU importers who have been traditionally importing from Bangladesh have stopped putting orders for Bangladeshi knit-RMG products. A large part of Bangladesh's traditional share is being taken over by Turkey

[10]EPB has so far refused to give in writing that those COs did not conform to EU requirement and should thus be cancelled. Eu is adamant on this issue as it will need to have the legal backing of such a statement from EPB in case any complaint is lodged by an aggrieved importer in a court of law.

[11]The amount of fine imposed on the importers is equivalent to about $25-30 million which is equal to the duty waivers received. The importers are now trying to reach some sort of understanding with the Bangladeshi exporters regarding payment of this fine (i.e. sharing of the burden).

which has been a close competitor of Bangladesh's T-shirt market in EU.[12] This will no doubt have serious negative multiplier effect on Bangladesh's exports sector as well as her overall economic performance.

Bangladesh has now requested EC to waive the 3-stage conversion criterion for her as a LDC and requested EC instead to apply the two stage processing criteria for knit-RMG products (yarn to knit-fabric and knit fabric to knit-RMG). This issue was also raised at the *Singapore Ministerial Meeting* of the WTO where as the leader of the group of LDCs in the WTO, the Bangladesh case was heard with sympathy. Initially, EC asked Bangladesh to seek preferential treatment under the clause of *regional cumulation*. According to the EU GSP provisions under regional cumulation regional countries can jointly seek GSP preferential treatment in which case only materials not produced in the regional group are counted as *non-originating*. However, regional cumulation is not very attractive to Bangladesh because the range of tariff reduction in this case will be determined according to which country makes the maximum value addition within the region. According to the existing rules, Bangladesh will receive duty reduction applicable to India, because given the existing production pattern of knit-RMG it is in India where the maximum value addition is made. India, as a developing country (and not a LDC) receives only 15% duty reduction under EU GSP (and not 100% as is the case for LDCs). Thus regional cumulation will leave Bangladesh with 15% duty waiver instead of the current 100%, making her exports less attractive for the EU importers. Initial computations made by Bangladesh Ministry of Commerce show that in terms of price of knit-RMG products

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[12]The number of T-shirts exported to EU by Bangladesh and Turkey was 152 million and 71 million in 1995.

reduction of tariffs by 15% instead of 100% will substantially erode competitive edge of Bangladesh in the EU market and will lead to trade deflection.

One possible way of resolving this problem is to automatically allow 100% duty rebates to LDCs even under regional cumulation. The other is to allow a two-stage conversion. Bangladesh is currently trying hard to impress EU to allow exports of knit-RMG under two stage conversion. In reply to Bangladesh's request for derogation to two stage conversion EC has informed the Bangladesh government that the request was under active consideration. Meanwhile EC has decided to go ahead with cancellation of the false COs it had identified and collect back the duties which were waived from the importers. As decisions about derogation may take a couple of months the whole sector is currently facing tremendous uncertainty. UK customs have decided that, with immediate effect, security for the full amount of duty must be provided for any knitted garments declared for GSP from Bangladesh before they will be released for free circulation.[13] Information paper issued in January by Joint Customs Consultative Committee (JCCC) of UK also informed about this new provision of depositing full security pending the outcome of enquiries to establish entitlement to preference of

[13]For example Coopers and Lybrand, the London based leading market analyst, informed its clients that up to 90% of garments imported to EU under GSP were not entitled for preference, rather than the 75% previously suggested. It also cautioned that GSP has not been withdrawn from Bangladesh but the importer will need pretty good evidence to convince anybody that any knitted garments are eligible. Although there are discussions regarding simplification of GSP rules of origin for the least developed countries nothing has been agreed upon, and when it is, it will not be backdated. Likewise, the EC has not agreed to waive its demands for back duty. (Statement issued on Jan. 27 1997 as quoted by *The Daily Star*, Bangladesh dated 14th February, 1997).

particular consignments. The EPB meanwhile, after Jan 23, 1997 is issuing COs only on the basis of inland b/b L/Cs.

The EC has now (August 1997) threatened to withdraw the GSP facility altogether if Bangladesh authorities fail to cancel the false GSP certificates and it has set a deadline - October 1, 1997. Besides, cancelling the 6,910 certificates identified by the EC mission, EC has also asked Bangladesh to investigate the authenticity of the 8,562 certificates the mission had earmarked as *doubtful*. EC has given indications that it is ready to consider Bangladesh's request for derogation, but only after false GSP certificates had been cancelled and necessary investigations carried out as regards the doubtful certificates. [14] The government is currently reviewing the situation. However, in all probability, the government will not take any concrete step till September, 1997 when the Minister for Commerce and Industries will visit EC head quarters in Brussels, Belgium.

This uncertainty about exports of knit-RMG comes at a time when Bangladesh had been bracing herself to prepare for the consequences of the phased withdrawal of MFA by the year 2005. It has already been mentioned that RMG exports from Bangladesh to U.S. market is regulated by the MFA.[15] So far

[14] If Bangladesh cancels the 6,910 GSP certificates an estimated $ 28 million (Tk. 126 crore) may have to be given as compensation to EC importers. Cancellation of the other 8,562 certificates will entail a compensation of $ 30 million (Tk. 135 crore). This burden will have to be borne either by the GOB, or the respective exporters or partially by both. The authority of the EPB, and the credibility of the GOB, will be seriously undermined, once the fraud is officially recognised.

[15] The integration of the products covered by the arrangement will be achieved in three stages under a ten year transition period: 16% in the first stage (1995), 17% in second stage (1999), 18% in third stage (2002) and rest 49% in the fourth stage (end of the year 2004). Each importing country is free to choose which products to integrate from each of four

quota allocations for Bangladesh has provided the country a guaranteed and steady market in the US - exports of RMG to U.S. had reached about $1.1 billion in FY 1996. As textile trade is gradually integrated into WTO. Bangladesh will be facing increasing competition from other countries like India, China, Laos, Cambodia and Burma. As a matter of fact, the integration plan of US textile trade indicates that most of the RMG items of Bangladesh's export interest will be integrated in the last phase. Meanwhile, Bangladesh must take concrete steps to remain competitive and enhance the local value addition. Thus the problem related to knit-RMG has arisen at a time when Bangladesh is at a critical juncture - the future of her export led growth strategy, the strategy on which she has put her bet, will be put to hard test in the next few years.

It is important to draw attention to the fact that during the Singapore Ministerial Meeting held in December, 1996 the issue of trade preferences for LDCs has come up very prominently. Bangladesh as leader of the group of LDCs in WTO has presented a strong case for continued preferential access by the LDCs to markets of the developed countries. The EC has also agreed to consider the issue with sympathy and understanding. There was a general agreement, in principle, on the issue of providing zero-tariff access to LDCs. The signatories at the Ministerial Meeting had agreed to (a) a *Plan of Action*, including provision for taking positive measures, for example duty-free access, on an autonomous basis, aimed at improving their overall capacity to respond to the opportunities offered by the trading system; (b) seek to give operational content to the *Plan of Action*,

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groupings - tops and yarn, fabrics, made-up textiles products and clothing. However, reducts that remain restricted during the transition period benefit from a progressively increasing quota; existing quota growth rates are scaled up by 16% in first stage, 25% in the second stage and by another 27% in the third stage.

for example, by enhancing conditions for investment and providing predictable and favourable market access conditions for LLDCs' products, to foster the expansion and diversification of their exports to the markets of all developed countries; and in the case of relevant developing countries in the context of the Global System of Trade Preferences; and (c) organize a meeting with UNCTAD and the International Trade Centre as soon as possible in 1997, with the participation of aid agencies, multilateral financial institutions and least-developed countries to foster an integrated approach to assisting these countries in enhancing their trading opportunities.

In this context the idea put forward in the EU *Green Paper* on the extension of the more generous EU trade preferences available under the *Lome Convention* to other LDCs, the option of *Integration into the GSP*, needs to be carefully considered to assess its probable implication for LDCs like Bangladesh. This is one of the four options which has been put forward in the *Green Paper*. Such a multilateral GSP option, applicable for all the LDCs, bound in the GATT, and within the ambit of WTO, can give the LDCs a high degree of security in terms of enjoying continued preferential access to EU markets. It would also harmonise the non-reciprocal preferential trade policy of the EU and bring its full conformity to the WTO rules. Considering the problems faced by Bangladesh and other LDCs some changes in the rules regarding process criterion and rules of origin may need to be incorporated in the revised provisions. The key principles of trade preference under the Lome Convention such as stability, contractuality and non-reciprocity, and a more liberal rules of origin provision would mean that LDCs like Bangladesh can take maximum advantage of such arrangement to prepare their economies for the post-UR phase and further enhance their export sector performance.

It needs to be appreciated that the rules of origin and process criterion were introduced to encourage backward and forward linkage in the LDCs and to help them graduate from traditional exporters of primary and/or low value added commodities. However, due to policy failures, including lack of coherence between investment and trade policies, most of the LDCs failed to develop such linkages. Bangladesh, for example, only recently has taken up some of the necessary steps and introduced adequate incentives to encourage backward linkage in the RMG sector. The private sector is now making substantial investments in these areas. Any derogation and flexibility in rules of origin criteria thus needs to be made time-bound to ensure that LDCs continue to encourage and promote backward and forward linkages. Otherwise flexibility in rules of origin may discourage domestic investment, and can be counterproductive. It is here that the issue of foreign direct investment (FDI) flow attains added significance. In all probability, FDI is going to play a critical role for the development of all the LDCs in the near future. Bangladesh for example, is a member of the *South Asian Preferential Trading Arrangement (SAPTA)*. A *Free Trade Area (SAFTA)* is to be established by the year 2005. A key concern of Bangladesh is related to stimulating flow of FDI to the country in order to maximise the potential gains from the free trade arrangement. However, so far FDI flow to countries like Bangladesh has been quite insignificant averaging less than $ 40 million in the last five years. More generous access to EU markets may stimulate FDI flow to Bangladesh as investors would be encouraged to take advantage of the zero-tariff access enjoyed by the country. As environmental and quality standards become more stringent FDI flow attains added importance in terms of technology transfer to LDCs.

The aid-trade policy nexus also needs to be strengthened to address the issue of promoting indigenous capacity in these areas.

It is already well recognised that catering to only the lower segment of the demand curve in low value addition production has got obvious limits. *Comparative advantage* in cheap labour needs to be translated into *competitive advantage* through technological upgradation. Skill development and institutional support for moving into higher value added skill-intensive production process, where relatively cheap labour can enhance price competitiveness, is becoming increasingly important for LDCs like Bangladesh. As far as EC-Bangladesh aid partnership is concerned all of EC's assistance to Bangladesh is provided on grant basis - this has increased over the years from $ 14.1 million (FY 1990) to 77.4 million in (FY 1994). However, this amount was only 5.8% of total external assistance disbursed by the donors in FY 1995. Of this amount, 41% was for emergency and relief assistance, 20% for free standing technical cooperation, 35% for investment project assistance and 4% for investment related technical cooperation. In the present context, there is a growing need to strengthen EU trade policy with the assistance of the aid policy as far as LDCs are concerned. Integration into the GSP would also facilitate inclusion of new issues and an opportunity to include measures to help address the formidable supply side constraints in LDCs like Bangladesh. In order to do this, the aid policy will need to be focused in order to strengthen the capacity of these countries to reap the maximum benefits from trade preferences offered under an integrated EU GSP scheme. Such assistance will also stimulate flow of export-oriented FDI to LDCs in the SAARC as potential investors stand to gain from (a) zero-tariff access to EU market under the GSP and (b) zero tariff access to regional markets, specially India, under the proposed free trade arrangement in the South Asia (SAFTA).

**Concluding Remarks**

The analysis presented in the previous sections clearly demonstrates that EU GSP scheme has played an important role in stimulating Bangladesh's export sector performance in recent years. Of the 16 GSP schemes under which Bangladesh enjoys preferential market access the EU GSP scheme is by far the singlemost important preferential arrangement accounting for about 70% of all exports under GSP schemes. Excepting woven-RMG all other manufactured and semi-manufactured commodities exported by Bangladesh to EU markets enjoy zero-tariff access. There is also no quota for these in the EU market. The phenomenal growth of knit-RMG sector in Bangladesh in recent years owes its success mainly to its zero-tariff access to EU markets. However, environmental and quality standard requirements of EC (in case of leather and shrimp exports from Bangladesh), and the rules of origin requirements under existing EU GSP (in case of knit-RMG) an threatening Bangladesh's future prospect in the EU market. EC has already threatened to discontinue GSP treatment to knit-RMG exports from October, 1997. EC has also decided to ban entry of Bangladesh shrimp and frozen foods to European markets after August 15, 1997. Bangladesh must take energetic steps to overcome these serious crises, both through *short term* as well as *long term* measures.

Derogation into two stage conversion, indigenous institutional and technical capacity build-up to strengthen environmental and quality standards, changes in rules of origin criteria are some of the issues which Bangladesh will need to negotiated with EU in near future. In this context *Integration into the GSP* option put forward in the *EC Green Paper* (option 2) demand careful consideration. Such a broad-based GSP scheme can, while being

WTO compatible, be designed to specifically address the problems of the LDCs, specially in the light of the *Singapore Ministerial Declaration* of December 1996 where the developed countries agreed, in principle, to continue to provide the LDCs preferential access to their markets. The paper argues that, from a medium to long term perspective, in order to promote LDC capacities in backward and forward linkage industries and improve quality standards, the aid-trade nexus must be deepened and strengthened so that trade preferences can act as a stimulant to economic growth and development, and not act as agents of LDC's continued dependence on the developed countries. A holistic approach is thus called for in designing the LDC-DC relationship in this new era of globalisation.

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