

Bangladesh Trade Regime and the Elusive Quest for Export Diversification

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Abstract

Bangladesh's scheduled graduation from UN LDC status in November 2026 will narrow preference-based market access and expose structural vulnerabilities in an export model dominated by ready-made garments (RMG). This makes the quest for export diversification both essential and urgent. This paper traces the evolution of trade policy and shows that RMG expanded because firms could operate at world prices through bonded duty-free inputs, back-to-back trade finance, and expedited customs, while most non-RMG sectors remained constrained by complex protection, para-tariffs, slow refunds, and uneven standards capacity. At the same time, high tariff protection raised domestic prices and profitability (in domestic sales) well above what could be extracted out of exports, creating a persistent anti-export bias. The paper argues, with research evidence, that it is the protection regime that serves as a binding constraint to export diversification, not competitiveness. As LDC graduation narrows preference margins and tightens rules of origin across major markets, Bangladesh must shift from preference-driven to policy-driven competitiveness, which includes tariff rationalization as a priority. The paper recommends economy-wide replication of the RMG operating regime (rules-based duty-free world-priced imported inputs, standardized trade finance, digital and time-bound duty-drawback), tariff and protection rationalization to WTO-consistent neutrality, and upgrades to standards infrastructure, logistics, and trade finance. Externally, it prioritizes securing EU GSP+, targeted FTAs, and integration into Asian regional value chains. A sequenced 2025–2029 program can reduce concentration risk, broaden the export base, and convert graduation from a vulnerability into a platform for sustained, inclusive growth.

Keywords: LDC graduation, Export diversification, Export concentration, RMG, GSP+, FTA, Trade policy, Competitiveness

1. Export Diversification in Bangladesh's Development Context

In the decades following the 1990s, Bangladesh's export performance was exemplary, with double-digit annual export growth until 2022. However, this export performance was driven by a single product group, ready-made garments (RMG), which grew at an annual rate of 14.9%, resulting in the share of RMG in the export basket increasing from 40% in 1990 to 82% in 2022. Throughout the period, growth of non-RMG exports remained sluggish, averaging only 8.3%. Consequently, export concentration in one product group, RMG, became predominant, making the economy extremely vulnerable to external shocks. Furthermore, with LDC graduation approaching, the days of preferential trade privileges will soon be phased out. In the evolving trade landscape, export diversification has become a more pressing national imperative.

Current strategies for export diversification have proven ineffective. Despite more than two decades of government efforts, progress has been minimal, and export concentration has in fact deepened. Why? The focus of diversification strategies has been on “picking winners” by selecting thrust sectors, priority sectors, or development sectors for policy support, such as export subsidies, concessional tariffs, preferred access to banking and finance, and so on. These strategies have been futile, as evidenced by the lack of traction in raising the share of non-RMG exports in the export basket.

Some five decades from its membership in the Least Developed Country (LDC) group under UN classification by the Committee for Development Policy (CDP), if it happens¹, Bangladesh is set to graduate into a “developing country” category of the UN in November 2026. This comes after the country was already reclassified by the World Bank as a lower middle-income country (LMIC), -graduating from a low-income country (LIC)-underscoring the significant socio-economic progress made over the 50 years of independence. This achievement reflects durable progress through economic growth, poverty reduction, and structural transformation. But it comes at a time of turbulence in the global geopolitical and geoeconomic landscape. Global trade is showing signs of slowdown amidst the slide in globalization, rising protectionism and economic nationalism. Thanks to the emergence of “reciprocal tariffs” out of the USA, competitive advantage of nations is being upended by favorable trade deals with the largest consumer market of the world.

Professor Stephen Dercon of Oxford University described Bangladesh as a “success story of Development” (Dercon, 2022). Other scholars and development practitioners have also acclaimed Bangladesh's development progress, citing real GDP growth averaging 6% annually since 2000. Export growth, particularly led by the readymade garment (RMG) sector, has been acknowledged as the principal driver of this notable performance, with exports rising from about \$6 billion in FY2000 to \$45 billion in FY2025. RMG alone now accounts for roughly 84% of total export receipts, catalyzing large-scale job creation and women's participation and shifting the export basket decisively away from primary products such as jute, tea, and frozen fish toward manufacturing.

¹ Thanks to a concerted move by private sector market leaders, supported by most practitioners, the Bangladesh Government has sought a readiness review by the UN High Representative for LDCs which could eventually lead to a deferment of graduation by some years.

The policy architecture behind this performance was not accidental. The rise of the apparel sector was supported by a pragmatic policy package that offset the cost penalties of a highly protected tariff environment. The policy innovation in a high-tariff economy that drove the phenomenal growth of RMG exports was the allowance of duty-free imported inputs (world-priced inputs), back-to-back LC that aligned working capital with export orders, and green channel facilities for customs clearance. Alongside this was the broader trade reforms that liberalized imports by lowering tariffs and removing import bans, introduced exchange rate flexibility, and created more stable policies for exporters. Regrettably, these facilities were not applied to the non-RMG exports as a result of which export success was limited to the RMG sector till today, making export concentration a quagmire for policymakers of today.

While the RMG sector functioned in an environment that resembled free trade, most other sectors remained trapped under complex protection that made domestic sales more profitable than exports, coupled with administrative bottlenecks that reinforced an anti-export bias and stifled diversification.

This concentration creates vulnerability. Heavy reliance on a single category exposes Bangladesh to sector-specific shocks and to the erosion of preferential access as LDC-specific international support measures (ISMs), including duty-free/quota-free treatment with flexible rules of origin, are phased down after graduation. Although some markets will offer transitional arrangements or alternative schemes (e.g., standard GSP or conditional arrangements), margins will narrow, and compliance demands will rise. Two challenges need to be addressed: first, competitiveness must be preserved; second, it is imperative that Bangladesh diversify its export basket with higher-value RMG products and many non-RMG products that continue to be exported in small (and never expanding) volumes. The crux of the problem – anti-export bias of the protection regime – must be eliminated, standards and trade infrastructure established, complemented by strategically chosen trade agreements.

Against this backdrop, the paper juxtaposes LDC graduation within Bangladesh's long-run trade policy evolution, documents the scale and risks of export concentration, unpacks the drivers of RMG success, and assesses the implications of preference erosion across major markets. It then outlines a policy agenda to neutralize anti-export bias, replicate apparel's enabling conditions economy-wide, and align external market-access strategy with domestic capability upgrades, so that graduation becomes a platform for broader, more resilient, export-led growth and development.

2. Evolution of trade policy in Bangladesh²

Bangladesh's trade policy has alternated between two broad approaches. The first prioritizes the domestic market by encouraging local production to replace imports. The second looks outward, aiming to compete in global markets by promoting exports. The rationale for import substitution (IS) as a development strategy was based on its foreign exchange saving potential for economies that suffered from scarcity of foreign exchange and IS production was destined for the domestic market to replace competing imports. Research evidence is now plentiful showing that the IS strategy neither yielded rapid industrialization nor robust growth. On the other hand, there

² This section draws from Sattar (2024).

is overwhelming evidence confirming that economies embracing export-oriented strategies targeting external markets have grown rapidly. For many East Asian economies (e.g. China, S. Korea) export orientation was so intensive and industrialization was so rapid that they turned from poor countries to become developed economies within the span of under 50 years. There is no such historical evidence of rapid development or structural transformation of economies using the IS trade strategy.

Trade reform was not the immediate priority for Bangladesh at independence. An important exception, however, was the late-1970s policy package for garments that provided duty-free access to imported (i.e. world-priced) inputs and “back-to-back” letters of credit that allowed firms to finance those inputs against confirmed export orders. These measures gave apparel producers access to world-priced materials despite high tariffs elsewhere. Partnerships such as Desh Garments’ collaboration with Daewoo, combined with quota access under the Multi-Fiber Arrangement, helped launch an export industry that eventually employed millions, many of them women.

Global thinking shifted in the 1980s. Import substitution fell out of favor as protected firms failed to become efficient. Export-led models in Korea, Taiwan, and later China and Vietnam demonstrated stronger results. Bangladesh did not immediately embrace this shift. Aside from easing imports of agricultural inputs and deregulating domestic farm markets, policy changes were limited. In consequence, growth remained subdued, and, by the close of the 1980s decade, the economy faced a growth and balance of payments crisis.

The 1990s was truly the golden period of trade policy developments when you consider the whole gamut of radical changes in the trade policy regime that were launched at the start of the decade. At the close of the 1980s the economy was literally in shambles. GDP growth was anemic, foreign exchange reserves had reached rock bottom, and financing of the BOP deficit was at a dead end. The confluence of an economic and political crisis (collapse of Ershad regime and onset of democracy) paved the way for radical reforms. The economic mess left by the departing regime had to be cleared first to restore the economy’s potential for growth and poverty reduction. The WB-IMF stepped in to save the situation with structural adjustment loans and BOP support on the back of wide-ranging trade policy reforms. Much needed structural reforms were introduced that included measures for restoring internal macroeconomic stability through fiscal conservatism, market orientation and deregulation of investment, privatization of state-owned enterprises, a la Washington Consensus. Compared to the previous 20 years, the trade policy changes undertaken could be termed radical indeed and included (a) sharp reduction and rationalization of tariffs, (b) significant import liberalization through removal of bans, quantitative restrictions (QRs) and import licensing (end of license raj), (c) move from fixed to flexible exchange rates, and (d) limited convertibility of the current account. This time trade liberalization during the 1990s was deep and transformative. In 2001, a seminal World Bank study on the impact of trade liberalization on growth and poverty (Dollar & Kraay, 2004) listed Bangladesh among the “globalizers” of the developing world, confirming through empirical evidence that these globalizers were experiencing rapid growth in incomes and declines in poverty.

The radical trade openness reforms (though incomplete) fueled rapid growth over the next decades. The pattern of growth by decade is summarized below (Table 1). Average decadal growth was stable and rising by roughly 1 percentage point every decade.

Table 1: Decadal GDP growth rate of Bangladesh

Decade	Avg GDP growth rate (%)	Increment in average growth
1972–1980	2.6	-
1981–1990	3.7	1.1
1991–2000	4.8	1.1
2001–2010	5.9	1.1
2011–2019	7.2	1.3
2020–2024	5.8	-1.4

Source: Estimates based on BBS data

Progress slowed in the 2000s. Although formal tariffs continued to decline and the last quantitative restrictions were converted into tariffs, new levies such as regulatory duty and the wider use of supplementary duties kept overall protection high. The tariff structure also maintained a steep escalation, with inputs taxed less than final goods. This raised effective protection for domestic sales and reduced the incentive to export for most non-garment producers. Garments remained an exception because its policy tools offset the tariff wall. Other tradable sectors faced slow and partial duty-drawback refunds, longer clearance times, limited access to finance, and weaker testing and certification capacity. Over time, a dual system emerged: near-free-trade conditions for 100% export-oriented RMG and a more protected, complex regime for others.

To expand non-RMG exports we do not need to search elsewhere. If the policies that fueled RMG exports could be replicated for non-RMG exports, that would be the best export diversification strategy. Any compliant producer should have reliable, rules-based duty-free access to imported inputs. Back-to-back financing should be standardized beyond apparel. Accredited firms should receive fast-track customs treatment tied to clear compliance benchmarks. Protection should be simpler and lower, with fewer bands and a timetable to phase out extra duties, while revenue is safeguarded by a broader, more digital VAT³. A more flexible and predictable exchange-rate regime should be encouraged, and the tariff reduction on import-intensive consumer products to relieve inflation, innovative border systems, higher standards and certification, and carefully selected trade agreements are supposed to back up these reforms. To the point, Bangladesh should evolve its one sector export model to a wider platform by having the same straightforward time-tested solutions implemented in the economy.

3. Current scenario of Bangladesh exports

Over the past 50 years, Bangladesh economy has undergone structural transformation that is consistent with the stylized facts of development – as industrialization progresses, the share of agriculture declines over time. At independence, agriculture made up 60 per cent of GDP, declining to 11% in FY2025, while industry compensated for this decline by rising from a mere 10% to 37% today, with the share of manufacturing in GDP at a record high of 25% in 2025, well above the LDC average of 15% and the global average of 16%, indicating a durable shift toward higher productivity activities (e.g. exports). Bangladesh remains far from any trend of premature deindustrialization.

³ Bangladesh's experience with sharp tariff reductions in the 1990s, accompanied by import liberalization, shows little negative impact on customs revenues (Sattar, 2017).

This transformation has been powered by exports, led overwhelmingly by ready-made garments (RMG). With only \$2 billion in FY1990, merchandise exports rose to \$45 billion in FY2025 (i.e. more than 20 times in 35 years). In the process, manufacturing exports replaced primary exports (jute, shrimps, tea and leather) that were the dominant items in the early years (Fig.1). This transformation, of course, was driven by the phenomenal expansion of RMG exports that grew from a minor player in 1983-84 (\$31.5 million, 4% of exports) to a mammoth export item and foreign exchange earner, at 84% of the total. With about 8% share of global exports, Bangladesh is now the second largest single-country exporter of readymade garments. The sector contributes about 15% to GDP and employs some 4 million workers (Fig.2), the majority of whom are women. The number of factories also rose from 1500 in 1994 to about 4500 in 2020. Some of the world's most ecofriendly factories are now located in Bangladesh. As of August 2025, Bangladesh boasts having 258 LEED-certified green factories, with a significant portion holding the highest Platinum rating. 63 of the world's top 100 LEED-certified factories are located in Bangladesh. Job creation has been broadly inclusive, drawing significant numbers of women and workers from poorer households and districts with lower levels of formal education (Kabeer & Mahmud, 2004; Matsuura & Teng, 2020).

Figure 1: The value of RMG exports and Bangladesh's share of the global market since 1993

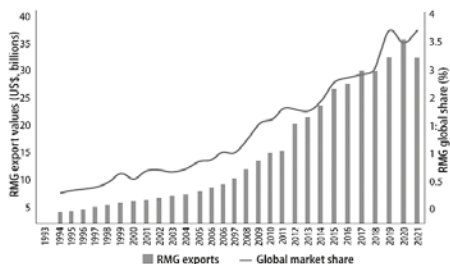
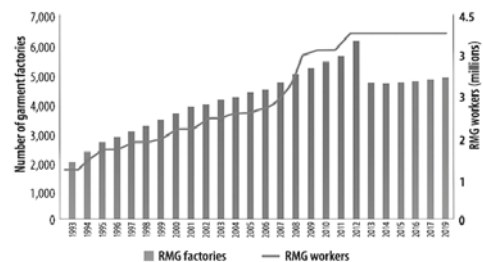


Figure 2: The number of RMG factories and workers since 1993



Source: Galal et al. (2025)

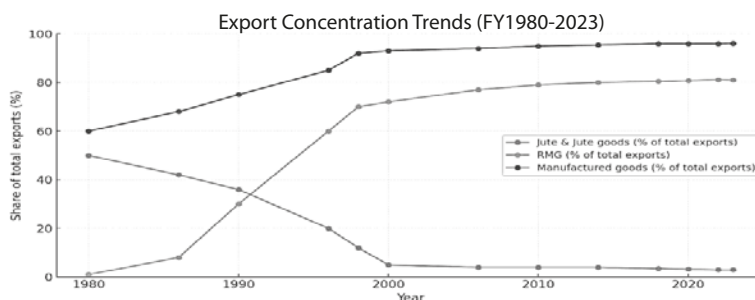
4. Export concentration in Bangladesh: scale and patterns

Bangladesh faces a persistent vulnerability as export earnings are heavily concentrated in ready-made garments (RMG), and that success has not been replicated elsewhere. Before the 1980s, a handful of primary commodities dominated exports. The takeoff of garments produced a brief window of diversification in the late 1980s, garment and non-garment exports were nearly equal (Figure 3), but the trajectories soon diverged. From the early 1990s to 2023, non-RMG exports rose from about US\$1 billion to just over US\$8 billion, while RMG exports jumped from roughly US\$1 billion to US\$47 billion. The result is one of the least diversified export baskets globally.

While the RMG exports have flourished, non-RMG exports have not done that well, leading to an increasing dominance of RMG exports in the Bangladesh export basket. Figure 3 captures the trend of export concentration in RMG over time. The share of RMG exports has risen from 30% in 1990 to 78% in 2000 and is now about 82% in 2023. If this trend toward concentration continues unabated, the share of RMG exports could hit 90% over the next five years.

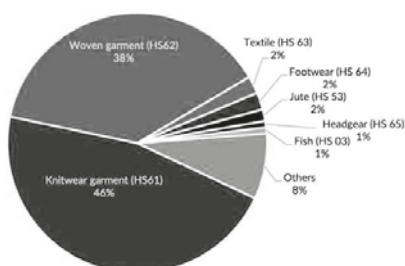
The product mix underscores this narrowness. Knitwear accounts for 44.6% of exports, woven garments 37.2%, home textiles 3.3%, footwear 2.3%, jute products 1.9%, and fish 1.0% (Figure 4). At the HS-6 level, the top 20 products make up around 80% of total exports, compared with 37–59% in China, India, Malaysia, and Viet Nam. The top 100 products exceed 90% of Bangladesh's exports, versus 69% for China, 73% for India, and 84% for both Malaysia and Viet Nam. Moreover, RMG products dominate even within this top-100 set, signaling very high concentration not only across the whole basket but also within clothing itself.

Figure 3: Export concentration in Bangladesh



Source: Estimates from NBR data

Figure 4: Export composition of Bangladesh in 2022-23



Source: ERD (2024)

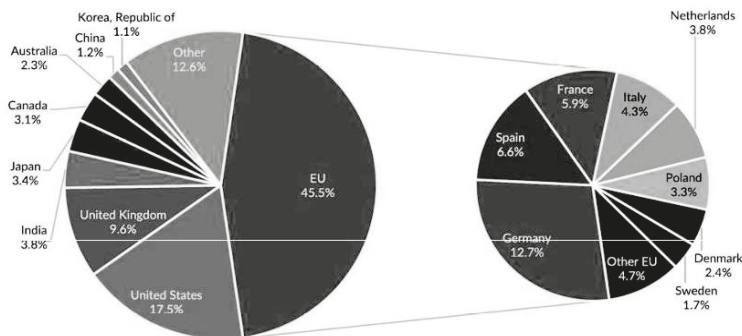
Bangladesh's exports are concentrated not only by product but also by destination. More than four-fifths of shipments go to North America and the European Union (Figure 5). There has been some progress: since 2000, the share of the top 15 markets in total exports has fallen from nearly 90% to just over 82%. Even so, cross-country comparisons show Bangladesh remains more concentrated than several regional peers. Its top 10 destinations account for about 72% of total exports, versus 52% for India and 64% for Sri Lanka. Looking at the top 20 partners, Bangladesh's concentration is roughly 90%, compared with 68% for India, 75% for the PRC, and 79% for Sri Lanka.

Estimates also point to sizable unrealized market potential, particularly in nearby large economies. Despite geographic proximity to India and China, Bangladesh under-exports to both (Kabir & Razzaque, 2020; Razzaque et al, 2020). The shortfall is estimated at around US\$6 billion to India and US\$2 billion to China. Under-exports extend to the wider neighborhood as well: the collective gap to South Asian partners is about US\$7 billion, and to Southeast Asia roughly US\$1.6

billion, together amounting to roughly one-quarter of Bangladesh's current exports to these regions.

The policy challenge is clear. Geographical diversification currently falls short but the prospects are bright, particularly in penetrating markets in Southeast and East Asia. For the long-term, Asia in all its parts is expected to effectively match the markets of Europe and North America, since Asian economies are moving close to producing 50% of world output (in PPP terms) in the near future. Targeting products where Bangladesh has revealed comparative advantage and deepening standards and trade infrastructure will go a long way towards geographical diversification.

Figure 5: Bangladesh's main export destination in 2022-23



Source: ERD (2024)

5. Unpacking the drivers of Bangladesh's RMG export success

Bangladesh's struggle to widen its export base becomes clearer when we look at why ready-made garments (RMG) expanded so rapidly (Sattar, 2014, 2021). Until the early 1980s, the country sold mostly primary commodities, jute and jute goods, tea, leather, and shrimp, with little footprint in manufactures. The surge in apparel was not driven by low wages alone; it rested on a purposeful policy package that offset the costs of a high-tariff environment and let exporters operate at world prices.

Three instruments did heavy lifting. First, the tariff-cost penalty was eliminated through special bonded warehouse (SBW) system that let firms import world-priced inputs such as yarn, fabric, dyes, chemicals, and accessories. Second, back-to-back letters of credit allowed those inputs to be financed against confirmed orders, aligning working capital with shipment cycles and lowering entry barriers. Third, "green-channel" customs streamlined paperwork and cut clearance times, giving buyers greater delivery certainty. Early technology transfer and MFA quota access helped firms learn faster, but it was this trio of policies that turned potential into scale.

The economy-wide payoff was large. RMG became the leading manufacturing industry, creating millions of jobs directly and through supply chains, and showing that with world-priced inputs, reliable trade finance, and quick logistics, Bangladeshi firms can compete on cost, speed, and reliability. Crucially, these are systems that can be copied, not one-off novel schemes.

Outside apparel, policy went the other way. High tariffs on final goods, widespread para-tariffs, and steep tariff escalation (inputs taxed below outputs) boosted the profitability of selling at home. Non-RMG exporters were left with slow, paperwork-heavy duty-drawback, less predictable border processes, thinner access to finance, and weaker testing and certification. The result is dualism: near-free-trade operating conditions for RMG alongside a protected, cumbersome regime for most other tradables, which discourages exporting even when firms have the capability.

The remedy is to apply the proven elements of the garments model across sectors. Priorities are:

- i. Creating universal, rules-based, duty-free input access for any compliant manufacturer, supported by e-invoicing, inventory e-ledgers, and risk-based audits;
- ii. Standardizing back-to-back financing beyond apparel with clear eligibility and safeguards;
- iii. Extending fast-track customs, Pré-arrival processing and AEO lanes, to accredited firms in all industries; and

Simplifying and rationalizing the tariff and protection structure by lowering output and input tariffs (including para-tariffs) in tandem while shifting the revenue focus to consumption taxes, such as a broader digital trade-neutral VAT. Trade reforms are not effective in a vacuum. It needs to be complemented with targeted structural improvements, such as sector-specific productivity and skill upgrading, modernization of trade infrastructure, harmonization of customs rules with key markets, and strategic free trade agreements.

In short, apparel's rise was a policy success that created the right operating conditions where they previously did not exist. Broad-based export growth now depends on extending those conditions, by rule, not exception, to the wider manufacturing base. Do that, and more sectors will progress from potential to performance (Sattar, 2014).

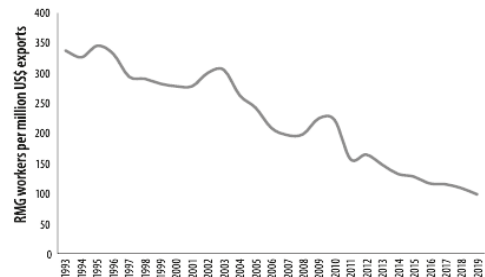
6. Export diversification challenge in Bangladesh

From the previous discussion, it is evident that since 1990, while the RMG exports have flourished, non-RMG exports have lagged, leading to an increasing dominance of RMG exports in the Bangladesh export basket (Sattar, 2023). However, Figure 6 traces RMG exports and employment from 1993 to 2019 and reveals a clear decoupling: exports have continued to rise steadily, but the workforce has been broadly flat since around 2012. Relative to export values, labor intensity has been declining for decades (Figure 7), reflecting rising productivity, greater use of capital, or both. The gender profile has also shifted. Women, who made up about 80–90 percent of employees in the early 1990s, now account for roughly half of the workforce (Kabeer & Mahmud, 2004; Matsuura & Teng, 2020). Going forward, the impending LDC graduation in 2026 (if it happens) hangs like a Damocles' sword on the future export performance of the Bangladesh economy, as trade preferences, particularly in Western markets, are tailored down (albeit with a 3-year grace period in EU, and sustained longer in countries such as China, Japan, Australia, New Zealand). Thus, for sustained robust growth in RMG exports and expansion with a diversified export basket, Bangladesh will need radical measures to achieve both product and geographical diversification.

Figure 6: The link between RMG exports and employment growth has deteriorated



Figure 7: The RMG sector's number of employees relative to exports has declined precipitously

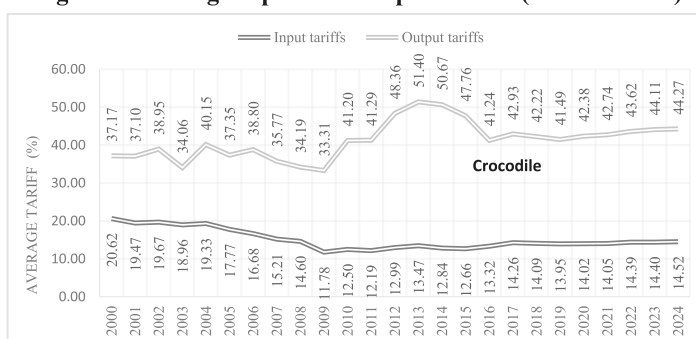


Source: Galal et al. (2025)

Several PRI and World Bank research (Sattar, 2012b, 2025; Kathuria & Malouche, 2016; World Bank, 2022, 2023) have described the degree and extent of export concentration in primary products in the Bangladesh's early years, now repeated in manufacturing exports of RMG. The same problem is echoed in Bangladesh's plan documents, the 6th, 7th, 8th Five Year Plans and the Perspective Plan 2041. Implementation, however, has been modest, and the constraints identified across these sources coalesce around an anti-export bias in the trade policy regime, discriminatory incentives against non-garment exporters, exchange-rate overvaluation, and pervasive weaknesses in standards, investment climate, power, land administration, logistics, and the overall business environment. Binding financial and capability gaps, limited access to credit and trade finance, skills shortages, low labor productivity, outdated technology, thin institutional capacity, inadequate R&D, and shallow participation in global value chains, further depress non-RMG competitiveness, explaining why diversification has lagged even as consensus on what to fix has solidified (ADB, 2016; Kathuria & Malouche, 2016; World Bank, 2022, 2023).

A central reason Bangladesh has struggled to diversify manufactured exports is the persistence of heavy trade protection (Sattar, 2019). As Figure 8 shows, average tariffs on final goods have long exceeded those on inputs, a classic case of tariff escalation. Lower input duties give producers cheaper raw materials, but higher output tariffs shield the domestic market from foreign competition, making local sales more profitable than exporting. Over time, the input–output tariff gap traces a “crocodile” pattern: a pronounced hump of elevated output protection during 2009–2015, followed by a plateau from 2016 onward, while average input tariffs have stayed broadly stable since 2009 at about 12–15%. Despite periodic rationalization efforts, para-tariffs, including some that are not WTO-compliant, have kept overall protection high and reinforced an anti-export bias. The RMG sector is largely insulated from these distortions through its bonded-warehouse, duty-free regime, a quasi “free-trade enclave”, but most non-RMG industries face the full weight of the protective structure. As long as import substitution remains more lucrative than exporting for these sectors, genuine export diversification will be out of reach. In short, the tariff regime is a binding constraint on export competitiveness and diversification.

Figure 8: Average Input and Output Tariffs (FY2000-2024)



Source: PRI estimates using NBR data

7. Trade policy dualism in Bangladesh

The export policy landscape in Bangladesh is a tale of trade policy dualism, with the 100% export-oriented RMG sector enjoying a privileged status while non-RMG exports do not. Duty-free imported inputs with deferred payments from export receipts and streamlined customs clearance procedures create a quasi-free trade enclave for RMG producers, facilitating their global success. However, non-RMG exporters face a different reality, navigating through cumbersome tariff structures and regulatory burdens. The crux of the issue lies in high and persistent tariff protection, which creates an anti-export bias by indirectly subsidizing import substitution, thus raising profitability in domestic sales above export profitability (Sattar, 2023).

Non-RMG exporters face a very different regime. They contend with high and complex tariffs, para-tariffs, and cumbersome regulations. A few firms obtain bonded-warehouse privileges, but most must rely on a slow, paperwork-heavy duty-drawback system that rarely delivers inputs at world prices. The result is a persistent anti-export bias: protection of final goods indirectly subsidizes import substitution, making domestic sales more profitable than exporting even where Bangladesh has a comparative advantage.

The remedy is straightforward: extending the RMG-style operating conditions to all compliant exporters, reliable duty-free input access, standardized back-to-back financing, and fast, rules-based border clearance, so firms buy at world prices rather than tariff-inclusive prices. Yet reform faces resistance from protectionist interests, and many producers that serve both home and foreign markets understandably prioritize the highly protected domestic market.

Until this bias is removed, diversification will remain stalled, and Bangladesh's export performance will stay tied to one sector. Today, RMG accounts for roughly 84 percent of total exports, a concentration that underscores the urgency of broadening the same enabling conditions across the rest of manufacturing.

8. Beyond competitiveness: How anti-export bias stalls diversification

In analyzing Bangladesh's export diversification challenge, the issue of competitiveness arises repeatedly. Is it a lack of competitiveness that stifles progress in diversification? What does the

research actually show? Sattar et al. (2024) conducted an in-depth assessment of competitiveness across Bangladesh's full range of exports, RMG and non-RMG, using revealed comparative advantage (RCA) and normalized RCA (NRCA). The findings are striking. In fiscal year 2021, Bangladesh exported 1,393 non-RMG products (HS-6 digits); 69% of these products were found to be highly or moderately competitive among roughly 40 suppliers to the same destination countries. Moreover, 90% of the 216 RMG products were in this highly competitive range, even relative to China. Footwear illustrates the point: after it was designated a priority sector, footwear exports grew by an average of 23% a year in FY2005–15 and 16 percent thereafter. The potential for product and market diversification is therefore substantial. In short, competitiveness is not what is holding back Bangladesh's export diversification (Sattar et al. 2024).

If competitiveness is not the barrier to diversification, then what is? Anti-export bias (AEB) is the economic phenomenon whereby a country's domestic incentive policies discourage exports in favor of import substitution. The principal driver of anti-export bias in Bangladesh is tariff protection and regulations that favor sales in the domestic market relative to exports. Put simply, the exorbitant rate of tariff protection granted to import substitutes creates a bias in incentives (i.e., a disincentive for non-RMG exports) by making domestic sales more profitable than exports. Thankfully, RMG exports are largely immune to such anti-export bias, as explained below.

Relative policy incentives accorded to exports versus import-substitute production may be configured through a formulation of effective exchange rates⁴ (which measures returns originating from nominal exchange rates plus any direct/indirect subsidies), for the two contrasting activities. Effective exchange rate for import substitutes (EERM) equals nominal exchange rate boosted by nominal protection rate (NPR), while effective exchange rate for exports (EERX) equals nominal exchange rate plus export subsidies, concessional credit facilities, etc. Then, relative incentives can be measured by the ratio of EERM and EERX, as follows:

Anti-export bias (AEB) = Effective exchange rate of import substitutes (EERM) / Effective exchange rate of exports (EERX)

In simple terms, this ratio demonstrates the trade-off between the gains from exports versus import substitution for an economic entity. The numerator, EERM, expresses the gain in monetary value from producing and selling a product domestically rather than exporting, whereas the denominator, EERX, captures the gain from exporting the product. Naturally, if the numerator is greater than the denominator, the incentives driving this gain are higher for selling domestically (i.e., import substitution). If the denominator is greater than the numerator, the incentives for exporting are higher.

The simple policy rule that emerges is as follows:

- If $AEB > 1$, policies and regulations favor domestic sales (import substitutes) over exports.
- If $AEB < 1$, policies and regulations favor exports over domestic production.
- If $AEB = 1$, policies and regulations are neutral on trade and neither favor nor hinder exports.

With the theory clarified, we can see how the non-RMG sector suffers from AEB while the RMG sector does not. Let's start with RMG. The RMG industry is immune to the effects of AEB

⁴ Not to be confused with inflation adjusted effective exchange rates.

for two main reasons: (a) the industry is 100% export-oriented and does not have the option of selling domestically under protective duties; and (b) the duty-free regime in which the industry operates supplies imported inputs at world prices, creating a level playing field for competing globally on the basis of comparative advantage in a labor-intensive product (i.e., ready-made garments). In the PRI study noted above, RMG products across the board had AEB values less than 1, as expected.

The story is completely different for the non-RMG sector. Unlike the RMG industry, which enjoys a quasi-free-trade regime, these sectors generally do not. Non-RMG firms face very high tariffs that provide protection from international competition by restricting imports and raising domestic prices. This discourages producers from entering global markets because there is more profit to be made in the domestic market, where outside competition is minimal. The cash export subsidies of 4% to 20% provided to these non-RMG exports are no match for the indirect subsidy arising from tariff protection, an average nominal protection rate (NPR) of about 45%, with a range of 56% to 150%. Consequently, it is economically rational for non-RMG producers to be reluctant to export while paying more attention to promoting domestic sales.

Another phenomenon that contributes to AEB is tariff escalation, imposing higher duties on final (finished) products than on the raw materials or inputs needed to manufacture them. This ensures that domestic producers face limited competition from international producers attempting to sell finished goods in the local market. The protection created by the gap between input and output tariffs is called effective protection, and it contributes to the discouragement of exports, thereby exacerbating AEB. This phenomenon is very strong in the non-RMG industries.

Moreover, non-RMG exporters operating in competitive global markets cannot pass on increased production costs due to import duties on inputs, which reduces profit margins and competitiveness. Purchasing inputs from local producers can also raise costs because protectionist measures and a lack of local competition keep input prices elevated.

Furthermore, the duty drawback system (DEDO) is inefficient and dysfunctional, resulting in delayed rebate collection and additional costs for firms. By contrast, the special bonded-warehouse (SBW) arrangement, used effectively by the RMG sector in a high-tariff environment, is available to only a small number of non-RMG enterprises. As a result, the RMG sector is almost completely immune to the tariff regime's anti-export bias, while most non-RMG producers remain exposed.

These logical conclusions are backed by research. Sattar et al. (2024) show, for instance, that jute products have AEB values of approximately 1.21; footwear products, porcelain, and ceramic kitchenware exhibit significant AEB values ranging from 1.60 to 1.69; leather-made goods contend with AEB of about 1.27; specialized textiles and home textiles face AEB values ranging from 1.25 to 1.41; and light engineering and domestic appliances exhibit AEB values of 1.10 to 1.30.⁵ Therefore, a large share of non-RMG industries display AEB values above 1, confirming

⁵ The PRI study used Nominal Protection Rates (NPR) to compute AEB. As output tariffs significantly exceed input tariffs, there is research evidence that effective rates of protection (ERP) are much higher than NPR. AEB measured by using ERP would indicate much higher rates of AEB, as ERPs are typically multiples of NPR. PRI did estimate ERPs through firm-level surveys in 2012, with only a tariff update in 2018 (Sattar, 2012, 2020). Without a recent wider firm-level survey, ERPs for such a vast number of non-RMG exports will not be available.

that policy-induced incentives, rather than a generalized lack of competitiveness, are the primary impediment to export diversification.

9. Export concentration in the context of LDC graduation

Bangladesh has benefited from LDC-specific support, duty-free and quota-free (DFQF) market access with flexible rules of origin, lenient trade commitments, concessional finance, lower multilateral contributions, and technical assistance, permitted under WTO provisions. These advantages were effective because domestic fundamentals were reasonably strong: coherent policy, adequate productive capacity, clear comparative advantages, and institutions able to absorb support. Graduation will unwind parts of this regime and should be evaluated against slower global trade, rising protectionism, strains in multilateral cooperation, geopolitical rivalry, and technology's labor impacts. The most consequential adjustments are trade-related. DFQF access that underpinned export growth, particularly in garments, will in many advanced economies revert to standard generalized system of preferences (GSP) where available; otherwise, most-favored-nation (MFN) tariffs apply unless offset by regional or bilateral agreements. In developing-country markets, graduates typically face MFN rates or preferences negotiated in regional trade agreements (RTAs).

Effects will differ by product and destination, the schemes that replace LDC treatment, and firms' ability to comply. Flows already outside LDC schemes or covered by other agreements will change little. Given heavy reliance on apparel, outcomes hinge on the European Union, with the United Kingdom, Canada, India, Japan, Australia, and China also critical; the United States offers no LDC scheme, so graduation has a limited direct effect there. Beyond apparel, leather goods, frozen fish, and shrimp may see moderate erosion. Overall, preferential margins narrow and LDC-specific flexibilities decline; the net impact turns on product mix, market exposure, availability of post-LDC schemes, and compliance capacity.

Across key partners, market access will shift in distinct ways. Canada's Least Developed Country Tariff (LDCT) covers about 99 percent of tariff lines, yet many flagship exports, garments, textiles, and footwear, fall outside developing-country GSP coverage, exposing a large share to MFN/GSP rates and tighter origin rules. India shifts from the South Asian Free Trade Area (SAFTA)-LDC zero tariffs on more than 11,500 products to the narrower non-LDC SAFTA regime with higher value-addition thresholds. China scales back LDC duty-free access on 99 percent of lines to reduced Asia-Pacific Trade Agreement (APTA) concessions, implying higher tariffs on most shipments. Japan currently grants DFQF on more than 95 percent of lines, but, post-graduation, major items, especially RMG and textiles, will face MFN rates. Australia is likely to retain broadly favorable duty-free access, yet Bangladesh's heavy concentration in RMG leaves it exposed. The United States has no LDC scheme, so graduation itself changes little there.

The policy response is straightforward. The days of preference-driven advantages in the global market is coming to a close for Bangladesh. So, it is time to get moving on ensuring policy-driven competitiveness. The key policies articulated in this regard include eliminating anti-export bias for non-RMG exports, providing duty-free (world-priced) access to sectors beyond RMG, streamlining and harmonizing border rules and procedures, and, most importantly, rationalizing tariffs and para-tariffs to make them WTO compliant, while safeguarding revenue through broader VAT and direct

tax measures. Furthermore, there is no time to waste in the pursuit of EU GSP+ by meeting tighter rules of origin requirements, labor and environmental standards, and seeking strategic free trade agreements. Clearly, the goal must be to support sustained export growth by substantially reducing export concentration risk and vulnerability.

10. Key Policy Recommendations

Trade policy reforms that began with a bang in the early 1990s have petered to a halt and even some backsliding in recent times. Nevertheless, the radical change of direction initiated in the 1990s has yielded substantial economic dividends for the country and is still continuing, while new challenges mount on the trade front as LDC graduation looms. An interim reform-oriented Government has taken over the helm of affairs in Bangladesh since 5th August 2024. This is the right time for another bout of substantial reforms on several fronts, including trade policy, which is currently beholden to high protective tariffs.

The key policy recommendations for a reform agenda that prioritizes addressing the challenge of export diversification would include the following:

(i) Replicate the RMG model

The first and most direct response to the diversification challenge is to extend to non-RMG sectors the same operating conditions that have long empowered RMG to scale. In practice, this means ensuring that smaller, mixed-market industries receive all, or at least most, of the incentives and provisions that have supported apparel's rise: predictable duty-free access to imported inputs, back-to-back trade finance, and streamlined border procedures tied to clear compliance standards. Unlike the RMG industry, most non-RMG sectors are not fully export-oriented; their production is split between domestic sales and exports, which makes them especially sensitive to the profitability gap created by the current protective structure. Although there are policy signals that appear to favor granting non-RMG exporters, whose production is only partially geared to exports, special bonded warehouse (SBW) facilities or comparable mechanisms to secure duty-free imported inputs, implementation remains piecemeal and falls short of a general, rules-based policy.

The sensible course is to enable these industries to achieve economies of scale by operating at world prices. Concretely, this can be done by adopting and operationalizing the National Tariff Policy (NTP) 2023, which stipulates that firms producing for both export and the domestic market may import inputs intended for exports duty-free by posting a 100% bank guarantee against such imports, up to 70% of export value. In simpler terms, this creates a bond facility, capped at 70% of export value, that allows firms to import raw materials entirely duty-free for export processing, effectively replicating SBW treatment for non-RMG exporters. This provision should be applied economy-wide and accompanied by an overhaul of the Duty Drawback (DED) system so that refunds are transparent, digital, auditable, and time-bound, thereby aligning cash flows with production cycles and encouraging firms to scale export operations (Sattar, 2023a).

(ii) Rationalize the structure of tariffs

Tariff protection, by undermining incentives to non-RMG exports, has become a binding constraint to export diversification. The second, and in our opinion, the most important solution is to reform the trade regime through rationalizing the tariff rates. Currently, Bangladesh hosts a very complex and convoluted tariff structure with numerous para-tariffs, most of which are WTO-non-compliant. Bangladesh can, at the moment, get away with such a structure because of its LDC status. But upon graduation in 2026, it will be impossible to hold on to such a structure⁶. Therefore, it is imperative to gradually phase out the para-tariffs and place trade neutral taxes which would not negatively affect exports by way of anti-export bias explained in previous sections. Moreover, rationalizing the tariffs will enable the exporters of non-RMG goods to access imported raw materials at competitive world prices. This will reduce cost and make these products more competitive in the world market and thus help diversify the export basket.

(iii) Additional measures

On top of these fundamental reforms, Bangladesh must address long-standing bottlenecks in trade logistics, access to trade finance, and standard international compliance, since these factors will ensure the profitability and reliability of exports.

First, reducing the time and cost of cross-border trade requires improving logistics across both processes and physical infrastructure. While deregulation, simplification, and full automation of customs and border agencies are essential to streamline processes and speed up clearance, improving network efficiency and reducing variability in delivery times requires targeted investments in transport infrastructure.

Second, to promote new exporters, Bangladesh needs to broaden access to low-cost trade finance, especially for SMEs and new exporters, by strengthening and redesigning the existing instruments, such as the Export Development Fund (EDF) and the Export Credit Guarantee Scheme (ECGS). In addition, drawing lessons from competing countries like India, Indonesia, and Vietnam can help develop effective export credit agencies, while mobilizing blended finance from ADB, the World Bank, and the IFC can broaden access to trade finance for the country.

Third, accessing advanced markets requires strengthening compliance with international standards. For instance, the Bangladesh Standards and Testing Institute (BSTI) should receive sustained investment to modernize labs and certification services in line with international benchmarks, while exporters, particularly SMEs, should have access to discounted loans or vouchers to fund audits, testing, and certifications. If Bangladesh addresses these long-standing economy-wide constraints, it will help the country to improve export competitiveness across sectors, opening the window for a broader and more diversified export basket.

Finally, Foreign Direct Investment (FDI) can help Bangladesh grow its export basket beyond RMG. While Bangladesh already has wage advantages, the US–China decoupling and China+1 realignments create an opening for the country to position itself as a favored destination for export-

⁶ The outcome documents of the 13th WTO Ministerial (MC13), held in February 2024, reveal that members have been advised to exercise “due restraint” in reacting to instances of non-compliance by graduating LDCs.

seeking FDI. Therefore, the country should move quickly to capitalize on this opportunity that may not last long. This requires targeted promotional initiatives along with ensuring a better business environment to attract FDI in both the RMG and Non-RMG sectors.

11. The Way Forward

Bangladesh's graduation from LDC status in November 2026 (if it occurs) validates five decades of progress and simultaneously tests whether the policy settings that powered that progress could sustain competitiveness without preference-based cushions. The export engine, anchored in ready-made garments (RMG), drove growth, jobs, and female labor force participation, but also created concentration risk and exposure to preference erosion. As duty-free/quota-free access narrows and rules of origin tighten, outcomes will turn on domestic policy neutrality for exporters and the credibility of Bangladesh's external market-access strategy.

The core diagnosis is clear: diversification has been held back less by firm capability (competitiveness) than by incentives that favor domestic sales over exporting beyond the RMG enclave. High tariff protection supplemented by para-tariffs raises the relative returns in the home market. Correcting this anti-export bias, so that non-RMG producers can buy at world prices, finance orders predictably, and clear borders quickly, is the shortest route to broad-based export growth.

The reform priorities follow directly. First, make the RMG "rules of the game" the economy-wide norm: rules-based duty-free input access (via the National Tariff Policy 2023 mechanism), standardized back-to-back finance, time-bound digital drawback, and AEO/green-lane clearance for accredited firms. Second, rationalize protection to WTO-consistent tariffs by phasing out para-tariffs, compressing bands, and shifting revenue toward a broader, digital VAT, closing the input–output protection gap that discourages exporting. Third, complement these domestic policy measures with seeking strategic FTAs, pursue EU GSP+ and other high-impact agreements, and deepen regional trade and value chain integration, particularly with Southeast and East Asian economies. However, export diversification strategies must not serve as a constraint to RMG expansion, a trend that still has tremendous prospects for sustained growth over the long term and Bangladesh's competitive advantage in this universal product is still unmatched, particularly in the basic garments category. Prospects are bright in the geographical diversification as well of RMG exports, particularly in non-traditional markets, across East Asia, Southeast Asia, the Middle East, and the Pacific, besides the neighborhood market of South Asia. In the long-term, these markets have the potential to rival hitherto traditional markets in Europe and North America. An important strategy would be to move up within apparel (especially man-made fibre and performance segments) and expand beyond it into under-exported, labor-intensive non-RMG lines and, critically, intermediate goods that anchor participation in regional value chains.

Past approaches, pursuing market access while leaning on export subsidies, did little to shift the non-RMG trajectory, when tariff protection trumped export subsidies by a wide margin. Left unchanged, concentration could rise toward 90% RMG before 2030. Trade theory and recent evidence indicate demand is not the constraint: most non-RMG products hold tiny global shares, implying room to grow if domestic incentives change. Indeed, average tariffs faced by many non-RMG items are lower than those on apparel in major markets, yet lenient domestic conditions and higher margins at home have kept potential exporters inward-oriented. The future challenge,

therefore, is not merely to find markets, but to rebalance incentives between domestic sales and exporting so that firms choose to compete abroad.

Execution and sequencing will determine credibility. A 2025–2029 glidepath that operationalizes the bond/guarantee duty-free scheme, digitizes and guarantees refunds, retires para-tariffs, and maintains a national rules-of-origin and compliance facility would lower uncertainty for buyers and investors. In parallel, at least one major access instrument (EU GSP+ or equivalent) and pragmatic early-harvest arrangements on customs, standards, and logistics with regional partners would anchor expectations while domestic reforms bite.

To conclude, one fundamental area of trade policy reform lies in eliminating the anti-export bias of current trade policy. Deep reforms in rationalization of the protective tariff structure – documented as a binding constraint- are needed to move the needle towards export diversification. If Bangladesh neutralizes the anti-export bias, preserves strengths in apparel while pushing into non-RMG and intermediate goods, and secures predictable, rules-based access, graduation will be a springboard rather than a shock, broadening the export base and strengthening resilience for the next phase of development. Otherwise, the quest for export diversification will remain elusive for a very long time indeed. Global headwinds, uncertain trade environment, trade slowdown, protectionist and national security turns, and compliance setbacks are real but manageable with disciplined and consistent trade policy. WTO “due restraint” guidance for LDC graduates offers a window to lock in reforms, not a reason to delay them.

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