1 Assessment and recommendations

Since gaining independence in 1971, Bangladesh has achieved significant progress. Its economy has transformed from one of the poorest in the world to a growing South Asian economy, home to a global manufacturing hub of ready-made garments (RMG). However, Bangladesh's achievements should not lead to complacency. The country is grappling with multiple challenges, from mitigating the impacts of climate change to preparing for LDC graduation. To secure a prosperous future, Bangladesh needs to prioritise new drivers of growth. It should shift from a price-led competitiveness model to one grounded on quality and innovation. Bangladesh also needs to shift its business mindset and modernise its policy approach for industrial development. Advancing on digitalisation and updating international partnerships are key to sustaining future progress. Above all, Bangladesh needs to future-proof the state to make it work as a value-driven and rules-based system. Chief in this transition from nation to state building is the modernisation of its institutional arrangements and the empowering of institutions to effectively deliver policies and operate in a highly dynamic and interdependent world.

Bangladesh has achieved remarkable progress to date

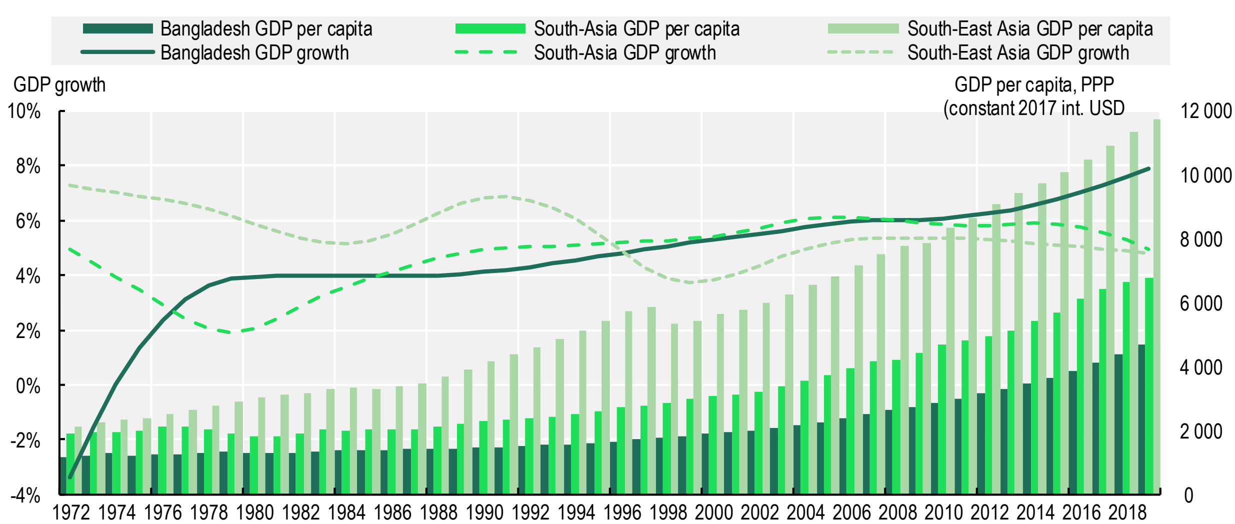
Sustained GDP growth and poverty reduction

Bangladesh, the eighth-most populous country in the world, with over 160 million citizens, and strategically located in South Asia, has considerable development potential. Since its independence in 1971, it has transformed from one of the poorest countries in the world into a South Asian growing economy home to a globally ready-made garments (RMG) manufacturing hub. Immediately after independence, Bangladesh was the world's ninth-poorest country, with a nominal income per capita of USD 95, infant mortality at 210 per 1 000 births, and an average life expectancy of 46.6 years. Today, Bangladesh with USD 460 billion is the 35th largest economy in the world by GDP size in current USD, with per capita GDP of USD 2 688 (current USD), and where infant mortality declined to 23 deaths per 1 000 births and life expectancy has risen to 72 years of age. The country has also gained international recognition as a model for poverty reduction. Considered by the United Nations to be a Least Developed Country (LDC) since 1975, it achieved lower-middle-income status in 2015 and today it is the largest graduating LDC, with graduation scheduled for 2026.

After negative growth rates in the immediate aftermath of independence, Bangladesh experienced annual average GDP growth of 4% until the 1990s. Albeit lower than in other economies in South and South-East Asia, this growth rate has sustained the country's progress. From the 2000s onwards, Bangladesh's annual GDP growth rate reached an average of 6%, and since 2010, the country's annual average growth outpaced the South-Asia average (Figure 1.1).

Figure 1.1. Bangladesh average annual GDP growth has outpaced the South-Asia average since 2010

Bangladesh GDP growth and GDP per capita, 1972-2019



Note: South Asia excludes Bangladesh. Regional aggregates follow UN classification. For GDP growth, HP filter was applied (lambda 54.12), according to OECD guidelines: http://dx.doi.org/10.1787/pdtvy-2016-en.
Source: Authors' elaboration based on data from Penn World Table (PWT) version 10.0. Real GDP at constant 2017 national prices (in mil. 2017 USD).

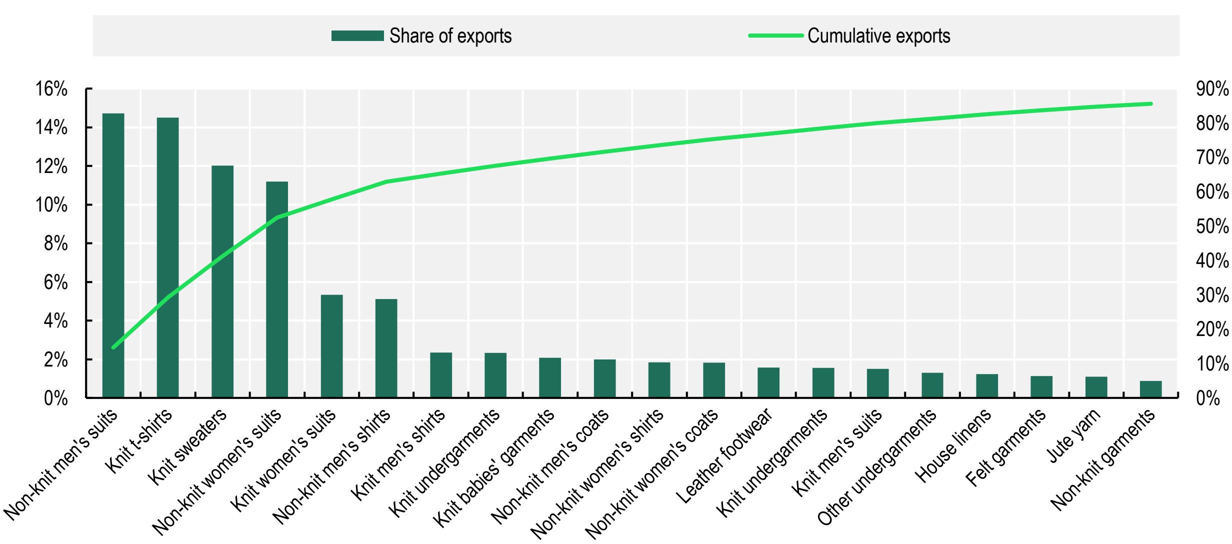
The establishment of a global garment manufacturing powerhouse

Since independence, Bangladesh has transformed from being a predominantly agrarian subsistence society into a global garments manufacturing hub. Industry accounts for more than 30% of GDP, with manufacturing representing 22% of GDP, up from 9% post-independence, while at the same time services rose to represent 50% of GDP, and agriculture declined from more than 60% to around 20% of the country's GDP. The European Union (EU) is the main trade partner for Bangladesh, accounting today for 50% of Bangladesh's exports, North America follows with 18%, of which 15% go to the US.

Born from a timely intuition to join the textile supply chain in the late 1970s the RMG industry has grown into the backbone of the Bangladeshi economy (Figure 1.2 and Figure 1.3). Today RMG accounts for 57% of the manufacturing domestic value added and for 72% of formal jobs in manufacturing. 20 RMG products represent 84% of all of Bangladesh's exports making the country the second-biggest RMG exporter in the world, following the People's Republic of China (hereafter "China"). RMG in Bangladesh is highly import dependent, and the country mostly imports intermediary inputs from Asia to make finished products that are then exported to leading brands in Europe and North America. Despite the growing quality of the items produced and an established reputation as a reliable business partner - corroborated by the improvements in responsible business conduct (RBC) after the 2013 Rana Plaza disaster - the success of the RMG business in Bangladesh ultimately continues to rely on extremely low business operational costs, including wages, which disproportionately impact women, who account for 80% of RMG workers. It also depends on targeted policies that support the industry.

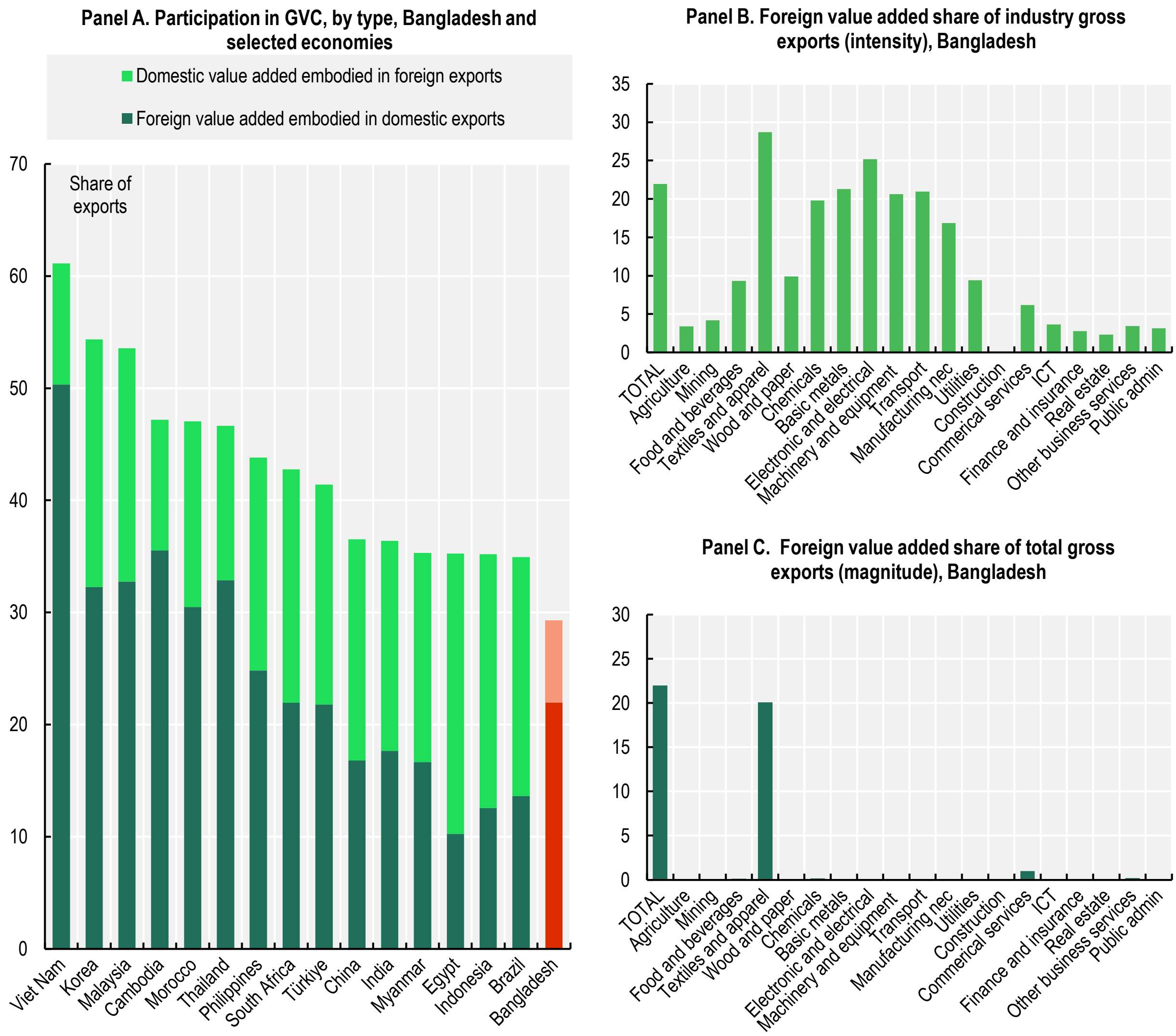
Figure 1.2. 20 RMG products account for 84% of all Bangladesh's exports

Top 20 exported products in total merchandise exports, Bangladesh 1998-2000 and 2018-2020



Note: CEPII developed a procedure that reconciles the declarations of the exporter and the importer, that may be different in the original data from COMTRADE
Source: Authors' elaboration based BACI HS 6 digits database, from CEPII http://www.cepii.fr, 2022.

Figure 1.3. To sustain RMG exports Bangladesh largely depend on foreign inputs



Source: Authors' elaboration based on OECD Trade in Value Added (TiVA) database, http://oe.cd/tiva.

Homegrown firms beyond RMG and incipient export diversification

Bangladesh remains anchored to an export-led growth model that relies on extremely competitive labour costs and a highly flexible business model capable of swiftly processing international orders. However, the country has also shown that it is quite capable of acquiring business know-how in more high-tech industries, including electronics and pharmaceuticals. Bangladesh has an incipient and growing electronics industry, of which 83% of the total output is marketed locally and a domestic pharmaceutical industry, focused on generic drugs manufacturing, which meets 98% of the country's essential pharmaceutical needs. Both industries target the domestic market, rely on domestic investment and local conglomerates and are heavily import-dependent. Targeted trade policies regulate the entry of foreign players and ease manufacturing costs for local producers by facilitating intermediary imports for domestic-oriented manufacturing activities. These two industries account for limited shares of manufacturing value added and even more limited shares in the country's exports, but both are growing and can play a key role in supporting Bangladesh's transition to a new development phase grounded in innovation and inclusiveness.

In global terms, Bangladesh's electronics sector is on par with that of Morocco and South Africa, accounting for around 0.07% of world manufacturing value added (MVA). It remains, however, smaller than the size of this industry in other Asian hubs such as Singapore (2.1%), Viet Nam (1%) and Malaysia (1.5%), where this sector is a major industry (48%, 27% and 24% respectively of their total MVA). Domestically, it accounts for 2% of MVA (i.e., approximately 0.3% of its GDP), and 1.2% of manufacturing employment. Production in Bangladesh is concentrated in lower-tech consumer products that are mostly sold on the domestic market. Home appliances – such as refrigerators and air conditioners – account for just over half (55%) of employment in the sector and a further 18% of the workforce is absorbed in the manufacturing of communication equipment, particularly mobile phones. By comparison, production in Viet Nam is relatively more diversified and oriented towards more technologically-intensive goods.

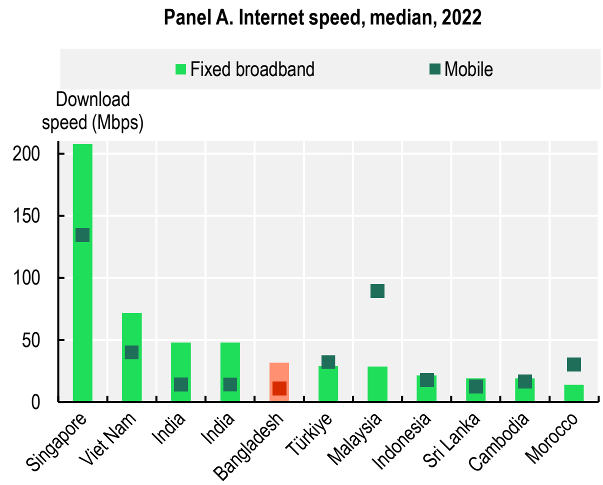
Globally, Bangladesh pharma accounts for 0.2% of the worldwide gross value added, comparable to countries like Egypt, Thailand, and Viet Nam, and trailing behind India, which accounts for 4%. Still Bangladesh is the only LDC operating in the pharmaceutical industry. Pharma represents 2% of Bangladesh total MVA and contributes 0.4% to its GDP. Drug companies employ 0.5% of the manufacturing workforce and offer salaries that are 2.6 times higher than the average manufacturing job in the country. Pharma in Bangladesh almost entirely relies on imports of sophisticated raw materials including active pharmaceutical ingredients (API), which account for 47% of all pharmaceutical imports. In fact, 90% of Bangladesh API demand is met by imports. Despite its international vocation, pharmaceuticals remain one of the least export-oriented manufacturing activities in Bangladesh. Pharma accounts for 1% of Bangladesh's exports (compared to the dominant RMG industry's 85%). Domestic exports have almost doubled over a decade, from USD 56 million in 2008-09 to USD 105 million in 2018-19, but they've grown at a rate of 6%, slower than total exports (9%).

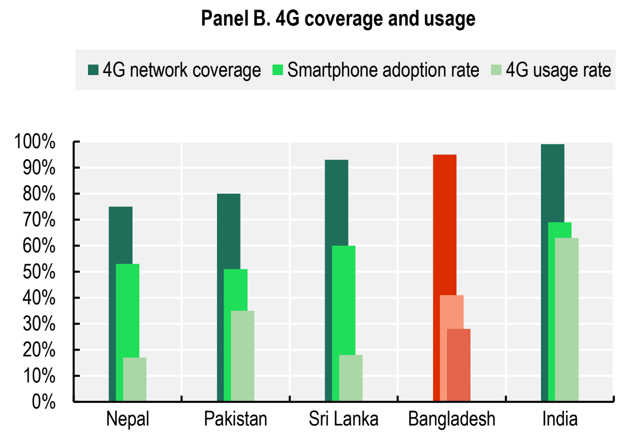
About 90% of Bangladesh's exports are finished pharmaceuticals, but only 7% of the total value added generated by the pharmaceutical industry is exported, setting it apart from countries like South Africa and India, where a larger share of value added comes from export revenues. An updated industrial strategy can transform the pharmaceutical industry into an ally as the country continues to diversify and upgrade its socio-economic structure. Pharma is an industry with major industrial linkages and spillovers, from agrifood to chemicals. It is an industry that operates via international networks, which requires a sound local science and research and development base. It is also an industry with major social implications, from its capacity to ensure availability and affordability of essential drugs to its well-paid direct and indirect jobs. The COVID-19 pandemic has also shown the needs for more geographic diversity when it comes to pharmaceutical manufacturing. In addition, availability and affordability of essential drugs remain an unmet goal for over 2 billion people in the world, according to WHO estimates. A sound, trustworthy, innovative and effective pharmaceutical industry in Bangladesh is in the country's, and indeed the world's interests.

Progress towards digitalisation

Bangladesh had advanced in digitalisation. The government has prioritised bridging infrastructure gaps and promoting access to digital technologies, under the Digital Bangladesh Vision 2021, and is now focusing, under the Smart Bangladesh Vision 2041, on using digital technologies to upgrade business and government operations. The progress achieved has been remarkable. Today, 4G coverage extends to 94% of the territory and fixed broadband subscriptions per 100 inhabitants doubled from 3 to 6.1 between 2010 and 2021. However, multiple and gaps persist. While internet usage rose from 3% to 25% of the population in the last decade, the current share remains quite far from other economies in the region, including Viet Nam where 70% of the population uses the internet (Figure 1.4). In addition, mobile download speed in Bangladesh remains very low - 11 Mbps in 2022 - only 1/3 of the global average and eight times slower than the fastest country, Singapore. These gaps limit the capacity of the country to fully reap the benefits of digitalisation in government and business, hampering users' experiences in digital transactions and limiting the usability of the government services, of which 66% have been commendably digitalised in Bangladesh.

Figure 1.4. Digitalisation has advanced, but gaps remain

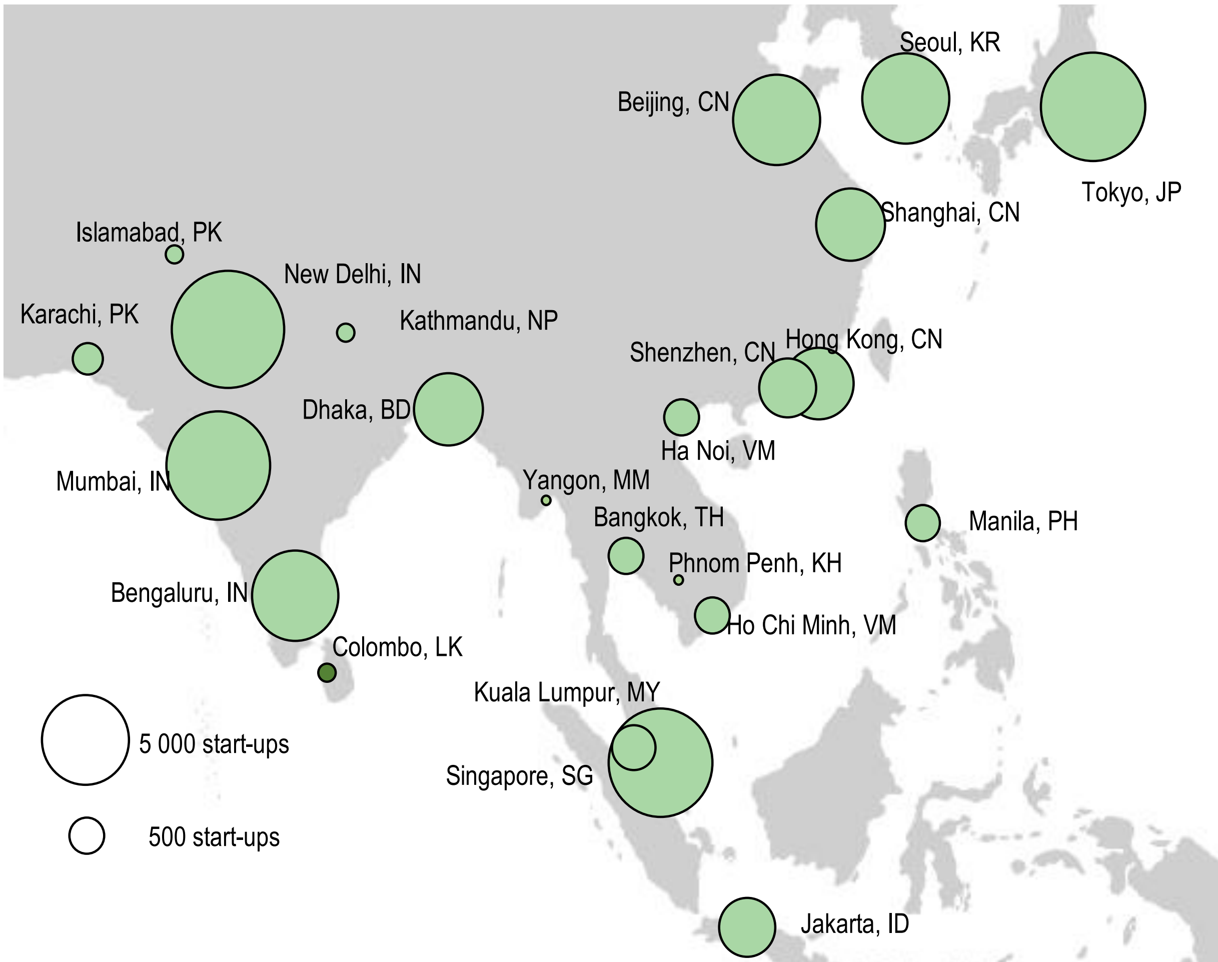




Note: Panel A. April 2022 median values (download speed in Mbps).
Source: Authors' elaboration based on Speedtest Global Index (Ookla), https://www.speedtest.net/it and GSMA (2021), "Achieving mobile-enabled digital inclusion in Bangladesh", https://www.gsma.com/mobilefordevelopment/resources/achieving-mobile-enabled-digital-inclusion-in-bangladesh/.

Digitalisation is contributing to enhance entrepreneurship and start-up creation. In 2022, Bangladesh was home to 2% of Asia's start-ups, up from almost zero around a decade ago. This 2%, even though small for a country the size of Bangladesh (India with a population 8 times larger is home to 23 times the number of start-ups, accounting for 40% of the region's total) puts the country on par with Viet Nam and Malaysia. Dhaka, the capital city, has grown into the 10th largest Asian start-up hub, home to 88% of all start-ups in Bangladesh or 12 start-ups per 100 000 people. This density is similar to emerging start-up hubs in the region, such as Shenzhen (China) and Ho Chi Minh (Viet Nam) (Figure 1.5).

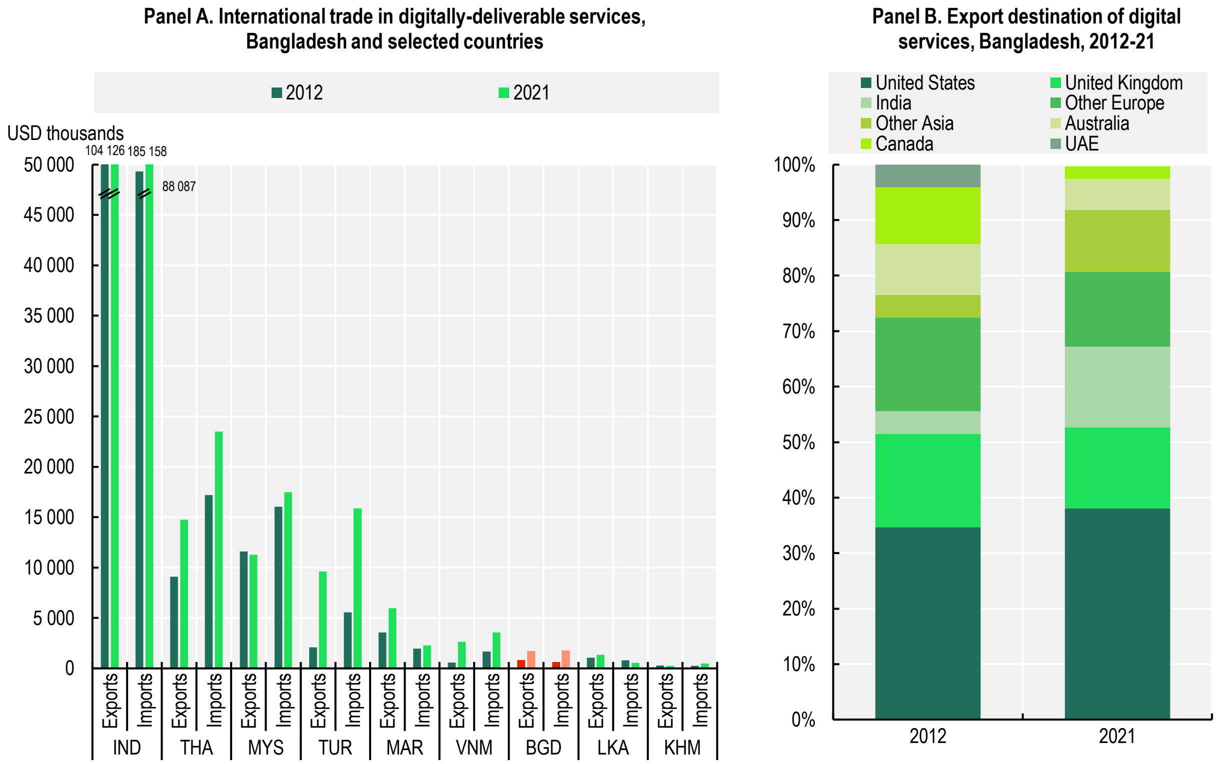
Figure 1.5. Dhaka is one of the emerging start-up hub in Asia, 2022



Source: Authors' elaboration based on Crunchbase (2023), database, https://www.crunchbase.com/.

Digitalisation is also contributing to diversifying Bangladesh's exports. The country's total exports of digital deliverable services grew from USD 780 million in 2012 to USD 1.73 billion in 2021, although this is still a far from its regional and global counterparts. Bangladesh has increased its exports of digital services to Asian markets, rising from 8% to 27% between 2012 and 2021 (Figure 1.6). While this sector promises economic potential, it also necessitates measures to address informality and ensure equitable working conditions.

Figure 1.6. Trade in digital services is growing but lags behind other countries



Note: Digitally-deliverable services are an aggregation of insurance and pension services, financial services, charges for the use of intellectual property, telecommunications, computer and information services, other business services and audio-visual and related services. The digitally-deliverable services series is based on the concept of potentially ICT-enabled services as developed by UNCTAD in a technical note in 2015 as well as in a report of the 47th United Nations Statistical Commission in 2016.

Source: Authors' elaboration based on UNCTADstat, https://unctadstat.unctad.org and Bangladesh Association of Software and Information (BASIS) annual report 2022, https://basis.org.bd/annual-report.

The current development model is under pressure due to global and domestic factors

Digitalisation and sustainability are reshaping global supply chains

The world is experiencing turbulent times, with escalating geopolitical tensions, mounting pressures arising from the exacerbation of climate change and an ongoing industrial transformation with digital technology profoundly impacting value creation appropriability and use. The industrial organisation model centred around global value chains and primarily driven by cost-competitiveness has reached its limits. In addition to global geopolitical tensions, there are two issues putting substantial pressure on supply chains globally and in Bangladesh: digitalisation and sustainability. Digitalisation is rapidly reshaping businesses and jobs, altering power dynamics, and affecting the generation, distribution, and capture of profits. Emerging technologies like the Internet of Things (IoT) and artificial intelligence (AI), coupled with evolving trade and investment trends, are changing work organisation, and diminishing the advantage of low labour costs. In addition, the acceleration of climate change is adding pressure to redefine work modes, production processes, consumption patterns, trade practices, and even overall societal and territorial structures to ensure economic practices align with the well-being of people and the planet.

Sustainability is also paramount for Bangladesh in relation to the future of RMG. Environmental concerns including groundwater pollution, airborne waste, soil degradation, and noise pollution require substantial attention and urgent action in Bangladesh. The garments industry's global carbon footprint is significant, accounting for 4-6% of carbon emissions and almost 20% of wastewater generation. Collaborative efforts and shared and transparent responsibility across the value chain, standardised practices and due diligence are key moving forward. RMG generates substantial waste in the country, notably pure cotton waste amounting to 250 000 tones out of the 577 000 tonnes produced in 2019. Recycling this waste could yield substantial financial benefits, while reducing imports of textile fibre. Initiatives such as the Circular Fashion Partnership hold promise in upcycling post-production fashion waste, which would be a step in collectively steering the sector towards a more sustainable future.

Climate change and natural disasters remain threats in Bangladesh

Bangladesh is among the world's most exposed countries to climate and weather-related hazards. Over 50% of its land lies below six meters above sea level and approximately 80% of its population is exposed to extreme weather risks. These challenges are exacerbated by rapid urbanisation, high population density, and gaps in infrastructure development. In addition to severely affecting human development, the rise in frequency and impact of disasters caused by the acceleration of climate change is also hampering Bangladesh's economic development potential and industrial competitiveness. Floods, driven by storms and heavy rainfalls frequently disrupt energy supplies, even with flood protection structures in place at thermal power plants. This severely impacts domestic agricultural production and disrupts transport and logistics, which leads to substantial economic losses in key sectors including agriculture, logistics and manufacturing. The vulnerability to natural disasters increases business uncertainty and trade unpredictability, increasing the costs of investing and doing business in Bangladesh. Easing vulnerability to climate change and natural disasters in Bangladesh is a human and an economic imperative that requires urgent attention to sustain future progress.

Transforming the economy is a pressing need

The current economic development model characterised by the overdependence on one export-oriented, import-dependent, low-tech, labour-intensive industrial segment (i.e., RMG) and the presence of a handful of local domestic-oriented, import-dependent conglomerates operating in a limited, albeit essential, consumer goods sectors has exhausted its capacity to deliver Bangladesh the inclusive and sustainable growth the world economy and the country needs.

The current economic model also makes Bangladesh increasingly and extremely vulnerable to external shocks and exacerbates Bangladesh's persistent trade deficit. The trade deficit is ballooning despite export growth, as imports have risen markedly due to growing energy and input needs to sustain established domestic and export-oriented industries, inflationary pressures and reduced remittances. The balance-of-payments deficit reached USD 7.2 billion in the first half of FY23, up from USD 5.3 billion in FY22, creating considerable pressure on foreign exchange reserves.

Labour productivity growth in Bangladesh remains excessively low, standing at 3% between 1990 and 2019. By 2019, Bangladesh's labour productivity was 9% of the United States, trailing behind India and Viet Nam, which albeit still far from the frontier, stand at 12% and 14%, respectively. The country risks being trapped in a low-wage and low-productivity spiral. Transforming industries to make them secure, safe and decent places to work for all individuals—and ensuring women are not discriminated against—is a key step forward in Bangladesh's next development phase.

Bangladesh remains the third-biggest recipient of official development assistance (ODA), after Syria and Egypt in absolute terms. While early development co-operation efforts focused on poverty alleviation, rural development and disaster preparedness, international partners are increasingly active in supporting

Bangladesh’s economic transformation. Overall, around 32% of total ODA to Bangladesh between 2018 and 2021, which rounds up to USD 8.9 billion, focused on economic transformation programmes, making Bangladesh one of the countries where ODA focuses the most on economic transformation. Within the ODA for economic transformation, infrastructure and energy account for the most, accounting for 75% of the total. India, China and Russia are also active in Bangladesh, especially in the transport and energy sectors, most specifically in power plants.

To continue succeeding, Bangladesh needs to update its business mindset and the policy approach

Bangladesh's achievements should not lead to complacency as deep fragilities persist and risk hampering future progress. Bangladesh is grappling with multiple challenges, from mitigating the impacts of climate change to preparing for LDC graduation. Additionally, the country must address the growing demands for increasing transparency and accountability in public and private actions arising from domestic and international stakeholders.

To secure a prosperous future, Bangladesh needs to prioritise new drivers of growth: shifting from a price-led competitiveness model to one grounded in quality and innovation.

The upcoming LDC graduation can serve as an important push to modernise domestic policy making and to update the international partnerships the country relies on and participates in. Bangladesh is poised to shift to its next development phase. Three issues emerge as pivotal: future-readying the state, shifting mindset in doing business and modernising the policy mix. Digitalisation and international partnerships are two powerful drivers of change that Bangladesh should harness to move forward and implement the reforms needed to continue succeeding.

Future-readying the state

Bangladesh needs to future-proof the state to endow it with necessary and modern institutions, transparency and accountability mechanisms, and domestic resource mobilisation capacities to operate as a modern, value-driven and rules-based system.

Despite its accomplishments, Bangladesh remains a young nation. The process of building a modern nation state is still in the making. Bangladesh is an institution-rich country. Currently the public sector consists of 42 ministries and a multitude of public institutions, agencies and committees often with overlapping responsibilities and reporting lines. The experience of countries with modern and efficient institutional arrangements shows that what matters most for creating an effective state is not the number of institutions *per se* but the quality and clarity of purpose of the institutions and the accountability mechanisms in place to measure impact and track progress. While Bangladesh has created numerous institutions and has made some progress in modernising the machinery of the state, the institutional structure remains unwieldy and top heavy, and in practice flagship initiatives continue to be driven from the highest level in government, making co-ordination at lower layers of the structure difficult.

Public expenditure is expanding but resources remain limited. Its total public budget in 2023 is USD 61 billion, which is approximately three times the total annual revenue of a multinational company such as H&M. Bangladesh needs more resources to invest in achieving a sustainable and prosperous future. In 2020, total tax revenues reached 10.2% of GDP. Although this is higher with respect to the 8.5% of 2007 and in line with Indonesia and Pakistan it remains lower compared to other countries in the region, such as Viet Nam with 22.7%, Philippines with 17.8% or Thailand at 16.5%. It also needs to increase its operational capacities. Overall, the country’s capacity to implement planned budgeted actions is less than 20%. The prevailing way of doing business remains too complex and personalised.

Advancing towards a rules-based, transparent, and accountable political and government system will be crucial. Simplifying and streamlining the governance system and continuing cutting red-tape will also be priorities. Empowering institutions and endowing them with the capabilities of functioning amidst the political alternation inherent in modern democracies is a gradual and learning-by-doing process, and Bangladesh needs to continue advancing in this respect. Multiple institutions with often overlapping responsibilities and a pivotal role played by the government leadership is a common feature in countries engaged in creating modern nation states. In the case of Bangladesh, this complexity carries an historical legacy that necessitates time for resolution to ensure national cohesion.

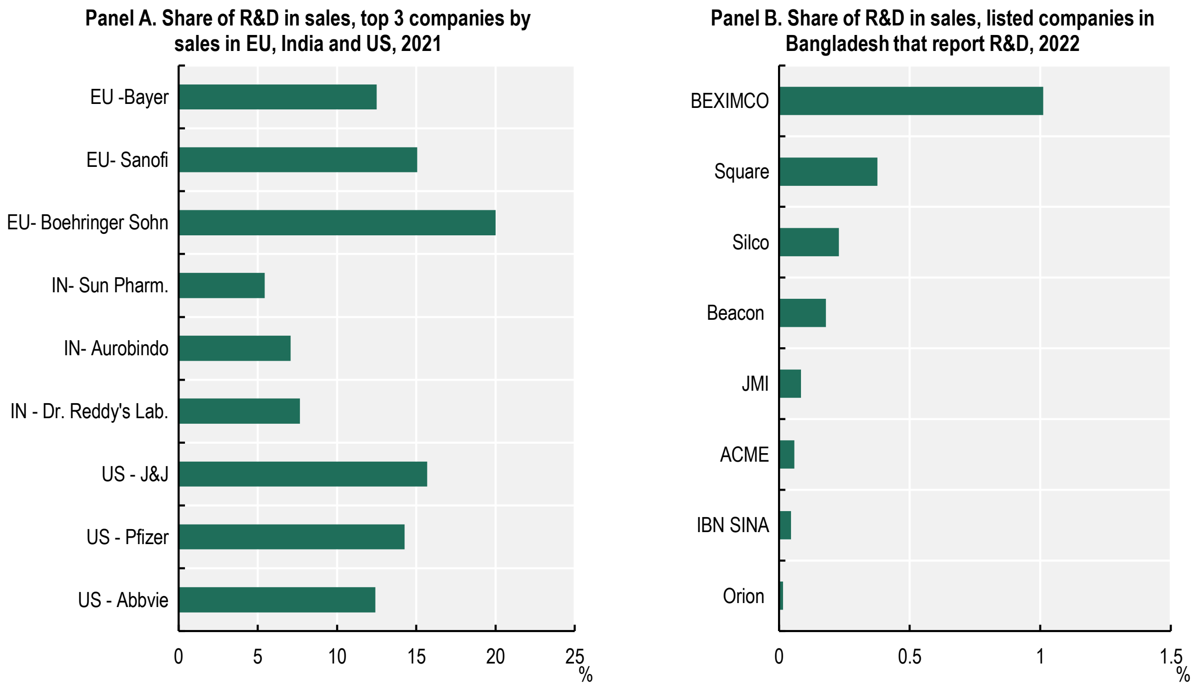
An empowered state, operating through effective institutions is also a transparent and open state. A pivotal objective for Bangladesh in sustaining its trajectory of success is to harness digital technologies, fostering enhanced efficiency and transparency in interactions between citizens, businesses, and the government. This entails facilitating government accountability across policies, investments, and expenditures by ensuring accessible information and responsiveness to the needs of citizens and businesses. The recent announcement to amend the Digital Security Act, issued in 2018, represents a step forward. It will be crucial that the amendments point to greater transparency and accountability.

Shifting mindsets in doing business

Bangladesh knows how to do business, domestically and internationally. Enhanced scrutiny of the social and environmental impact of businesses as well as the changing trade preferences associated with Bangladesh's graduation from LDC status are pushing the country to alter its business model.

Bangladesh has untapped innovation potential. In Bangladesh, only 1.2% of firms invest in R&D—less than half the rate observed in Indian firms. A mere 2.6% of Bangladeshi firms employ technologies licensed from foreign counterparts, in contrast to Viet Nam's 10.8% and Türkiye's 14.4%. Even in pharma, which tends to be a particularly R&D-intensive industry, Bangladesh invests little in research and development. The top two investing firms devoted 1% and 0.4% of their business turnover to R&D, compared to 15% of the top world pharma R&D firms. Bangladesh also suffers from overall gaps in technical and managerial skills for innovation. Pharma in Bangladesh should explore new business areas, including partnerships to serve pharmaceutical needs in LDCs and other poor countries in need. The industry should also engage more in prospective studies to identify future opportunities and to meaningful partnerships with local research centres.

Figure 1.7. Firms in Bangladesh invest little in R&D, even in pharma



Note: Panel A is calculated based on net sales which is defined as sales excluding sales taxes and shares of sales of joint ventures and associates. Panel B is calculated based on gross revenue/sales.
Source: Authors' elaboration based on EU (2022), The 2022 EU Industrial R&D Investment Scoreboard https://iri.jrc.ec.europa.eu/scoreboard/2022-eu-industrial-rd-investment-scoreboard, and Marketwatch (2023), stock financial statistics (database), https://www.marketwatch.com/investing.

Domestic firms in Bangladesh should step up in their innovation efforts and could play a more active role in fostering the development of a local innovation ecosystem. They could also benefit from the growing start-up scene in the country, and increasing linkages with academia and research centres. The private sector in Bangladesh should take responsibility in fostering an innovation-driven growth process, notably by improving traceability, increasing quality and compliance with international quality standards, as well as by investing more in R&D and innovation.

To do so, the government needs to update its policy approach and update the incentives it offers to the private sector. In fact, the conditions that propelled private sector development in Bangladesh are linked to a highly protected market environment and to a policy toolbox focused which—despite reforms—has remained fundamentally unchanged since the late 1970s. Changing business mindsets in the domestic and international private sector is not an easy task. It requires the modernisation of the policy toolbox to actually induce pro-innovation behaviours in firms. While there is no unique way to effectively craft a pro-innovation policy, global good practices point to the need to set up targeted innovation funds and to endow institutions with the capacity to mobilise resources through different mechanisms, from grants to fiscal incentives and insurance. This needs to happen at all levels of firms' development: from seed to expansion. Modernising the financing sector to inject in the system medium- and long-term financing for innovation is also a common good international practice. Targeted policies will also need to be included to ensure SMEs benefit from the incentives to innovate.

Bangladesh has homegrown firms, and although limited in number they have resulted in the formation of a domestic business elite. But businesses continue to be run in two prevailing modes: 1) selling basic and essential products catering to the domestic market; and 2) exporting cost-effective but labour-intensive products thanks to cheap labour. These two prevailing business strategies are nurtured by a targeted policy approach that facilitates domestic production through regulations and controls. This intervention limits the entry of foreign producers to serve the domestic market and facilitates access to imports for domestic manufacturing activities.

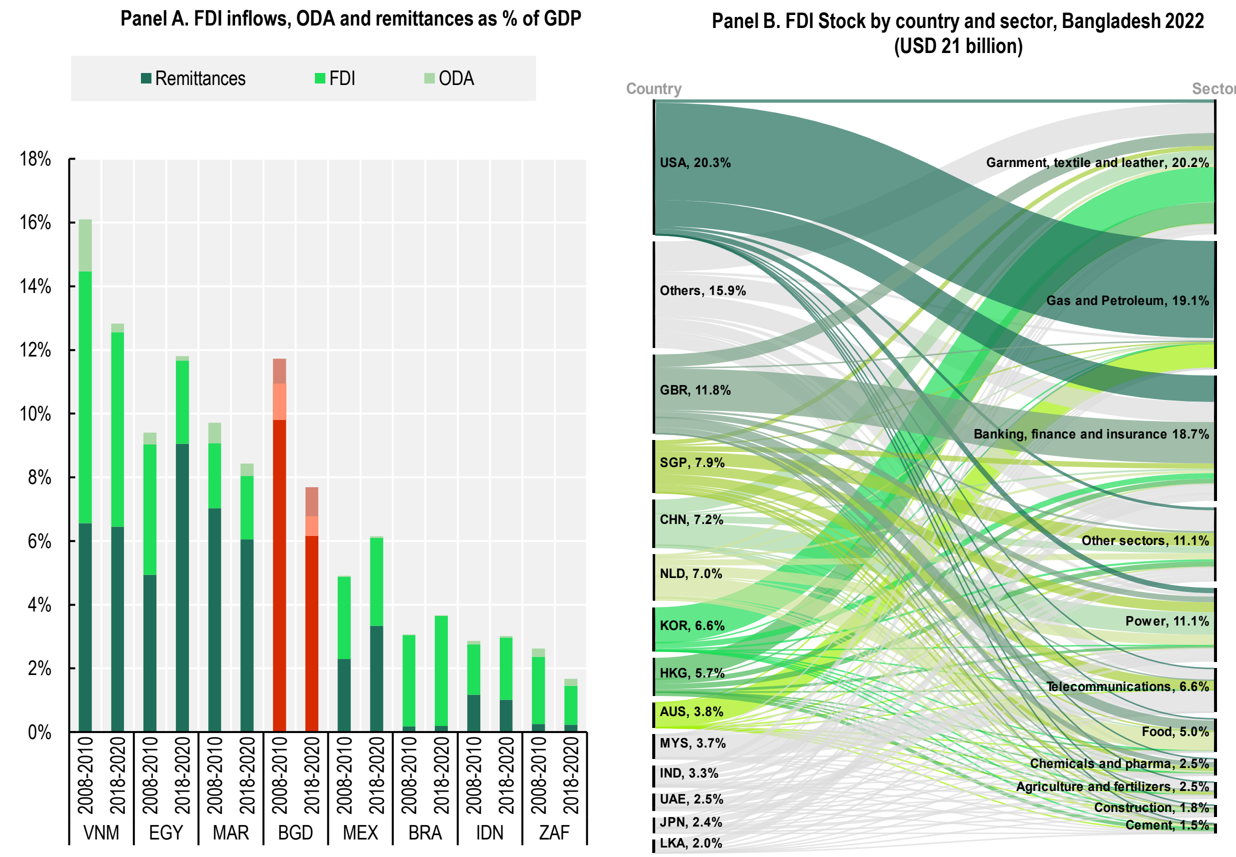
The prevailing price-led market-access mindset is the result not only of current incentive schemes, which actually lack targeted conditionalities to support innovation and learning, but also the prevailing approach of international partners, who still see in Bangladesh a business-deal and not an innovation partner.

FDI could also play a bigger role in fostering diversification, learning and innovation. Although attracting FDI is among the top government's priorities, FDI to Bangladesh remains limited and concentrated in traditional sectors. FDI accounts only for 0.7% of GDP in the country, versus 6% in Viet Nam and 2% in Morocco (data refers to 2018-20). During 2018-22, Bangladesh's remittances were seven times higher than FDI. The top two investors in Bangladesh are the United States and the United Kingdom, accounting for 20% and 11% of total FDI to the country.

In addition to being limited, FDI in Bangladesh reinforces the existing specialisation pattern. Contrary to the global trend where FDI significantly propels development in cutting-edge sectors, including environmental technologies which constituted about one-quarter of investments during 2018-2022, FDI in Bangladesh focuses on manufacturing (40% of total during 2017-22), with garments and textiles representing one-third of it, followed by food products (Figure 1.8). In garments and textiles most FDI continues to be driven by the price competitiveness of domestic production due to persistent low labour and environmental costs. Other factors include established contract manufacturing and outsourcing arrangements with leading global brands, mostly from the United States, Canada and Europe. To make the most of FDI and ensure it contributes to shift to an innovation-driven growth, the policy for FDI attraction, as well as the incentives in place need to be updated.

The EU, Bangladesh's main trade partner, has taken productive steps to enable a new, more innovation-oriented way of doing business in Bangladesh. In 2016, the EU established in collaboration with Bangladesh's Ministry of Commerce the EU-Bangladesh Government Business Climate Dialogue. The initiative operates as a platform to foster dialogue and promote reforms. In addition to identifying digitalisation as a key area for enhanced partnership between Bangladesh and the EU, the dialogue led to the creation of the EU Chamber of Commerce in Bangladesh. The entity, which federates EU businesses operating in Bangladesh, is a major positive step to support a shift and an upgrade in the way of doing business in Bangladesh. It holds promise when it comes to enabling domestic reforms and updating international partnerships. To maximise participation in the Business Climate Dialogue, the government of Bangladesh should set up clear institutional mechanisms to enact reforms discussed by the Dialogue.

Figure 1.8. FDI could do more for Bangladesh diversification and innovation efforts



Source: Author's elaboration based on World Bank, https://data.worldbank.org, UNCTAD stat, https://unctad.org/statistics and Bangladesh Bank https://www.bb.org.bd/.

Modernising the policy approach

Bangladesh needs to update its economic model to continue to succeed. To do so, it needs to diversify its export base, develop a strategic network of international partnerships, and foster a more innovation- and quality-based industrial development. It also needs to overcome the duality of its industrial model with an export oriented RMG sector and highly protected industries operating for the domestic market.

To get there, Bangladesh needs to reconsider its policy approach. The current policy framework is not conducive to creating a favourable environment for innovators. The legacy of a policy framework, resembling that of India and Pakistan in the 1950s, which heavily emphasises regulations and controls and reliance on domestic demand, without targeted policies to foster gradual upgrading and innovation, persists. Bangladesh's policy toolbox to support industrial development has not changed much since the early years of the country's founding. The accumulation of domestic industrial capabilities in Bangladesh, in RMG as well as domestic-oriented industries such as pharmaceuticals and electronics, relied on a combination of targeted domestic policies and a conducive international framework which allowed Bangladesh to substantially diverge from WTO rules on trade and intellectual property. LDC graduation will affect Bangladesh's capacity to use the current policy toolbox to continue nurturing industrial capacities and question the multilateral compliance of some of the specific policies adopted.

Since the 1980s, Bangladesh has focused on attracting FDI using simple but quite generous incentive packages, whose effect was limited by excessive complex institutional arrangement and the complexity of doing business locally. Not surprisingly, the impact of this approach to attract FDI has been limited. In addition, export support has remained fine-tuned to the needs of RGM, resulting in practice in an anti-export bias for other industries. And support to industrial competitiveness lacks incentives for learning and innovation and relies mostly on tariff management and direct non reimbursable transfers (Figure 1.9).

Policies will need to be upgraded and will need to shift from focusing on market access and tariff management to more modern policy tools. The current policy framework does not incentivise investing in innovation in domestic and foreign firms. It also limits foreign investors' appetite for investing in the country, despite its significant market potential and strategic geographic location. Bangladesh must further reduce red tape, enhance digital and physical infrastructure, and simplify the complexities of conducting business within its borders.

The current policy approach favours incumbent firms and protects the *status quo* while the country should look ahead and implement a modern policy mix that encourages learning, risk-taking, and innovation while at the same time providing new business opportunities for new firms and sectors. Despite the changes in rhetoric and policy branding, innovation is still not on the radar of Bangladesh’s policy approach. In fact, even in the use of TRIPS flexibilities more could have been done to effectively use them to enable shifting from pure manufacturing to incentivise research and innovation in the pharmaceutical industry.

LDC graduation will affect Bangladesh's flexibility to continue nurturing industrial capacities and poses questions about the international compliance of some of the specific policy tools in use. In particular, LDC graduation raises concerns regarding the overreliance on tariff management and direct subsidies. The expiration of the TRIPS waiver will also substantially impact the number of patents the country will need to consider and their validity date, therefore impacting local manufacturing capacities. This is particularly relevant for the pharmaceutical industry. However, regardless of the outcomes of the ongoing negotiations to extend the TRIPS waiver granted to LDCs beyond the Bangladesh’s graduation year (to match the deadline set for all LDCs in 2033) Bangladesh needs to update its policy framework to make it more modern, innovation-oriented, and therefore globally compliant. In particular, the country needs to:

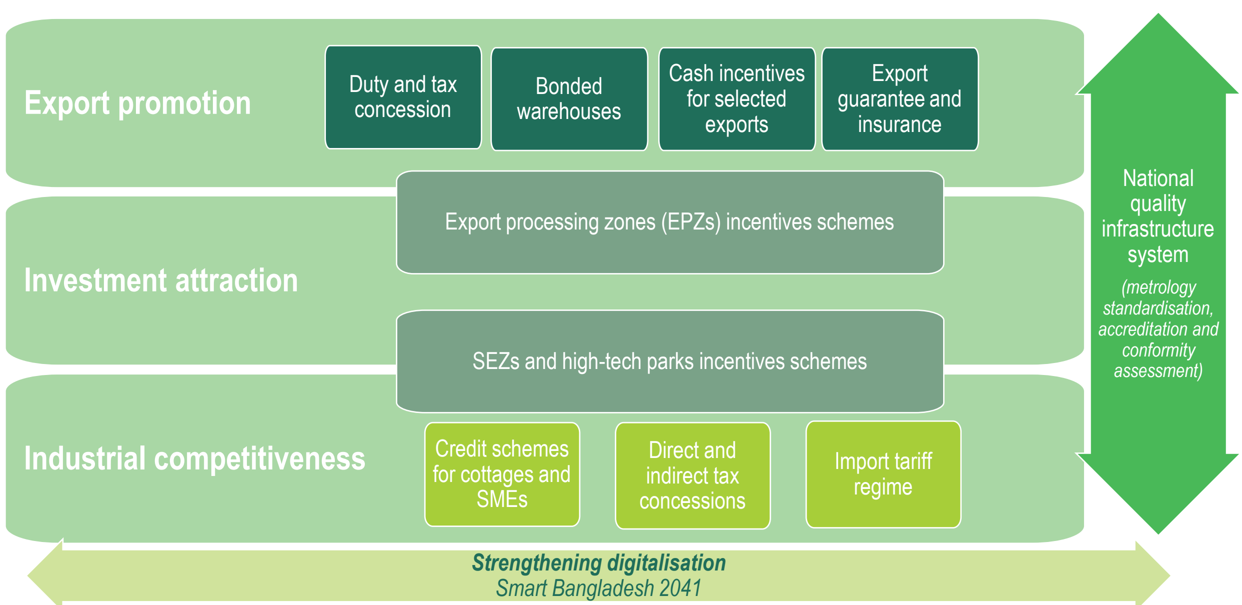
- Develop a more co-ordinated approach between industrial, trade and FDI policies to ensure they all act together to achieve the main objective of sustaining innovation and continuing to upgrade the Bangladeshi industrial system. Attracting FDI is the goal, but doing it in a way that fosters learning in the economy is equally important. A way to do this for Bangladesh would be to update the incentives packages and shift to a more targeted FDI approach, proactively looking to attract more knowledge-intensive FDI, and to introduce conditionalities to ensure that the local economy gets the most out of FDI.
- Simplify and clarify the institutionality for attracting FDI — currently comprising four different agencies with overlapping roles — is also necessary to increase the ease-of-doing-business. Despite progress, including the online platform launched in 2021 to serve as a one-stop-shop for investors, Bangladesh remains a difficult country for foreign investors to operate in, due to the persistence of personalisation in dealing with government-business relations and the high level of complex bureaucracy system. Bangladesh should modernise the institutional arrangement and endow the agencies in charge of attracting FDI with the tools and resources to operate in a more business-oriented way. For instance, the country needs to reconsider its institutionality and de-link its management from the state bureaucracy.
- Modernise the incentive packages to ensure local industrial development, innovation, and learning, including by developing targeted tools to foster innovation, strengthen the skills, knowledge and science base, as well as adding conditionalities to FDI incentive packages. This can be done in different ways and identifying an appropriate way for Bangladesh to craft its new policy mix is a crucial step in the ongoing process of state building. In particular, Bangladesh would benefit from setting up an innovation fund linked to major national innovation challenges, from greening and upgrading the RMG to fostering industrial upgrading in domestic industries. Progressively

Bangladesh should shift from a policy approach mostly focused on tariff management, to a more sophisticated one, relying on different schemes including setting up matching funds for innovation, where state support is subject to private sector investment. While Bangladesh's distinctive feature of micro-finance institutions has played a key role in poverty reduction, endowing the state with medium- and long-term financing capacities for national transformative projects should be contemplated in the journey towards becoming a high-income economy.

- Develop a strategic network of trade and international partnerships, including leveraging the potential of regional integration. Bangladesh is one of the least regionally integrated countries in Asia. While 75% of its merchandise imports come from Asia, only 16% of its exports are sold in the region. Bangladesh stands to gain from developing a targeted strategy to engage with Asia, including through ASEAN. The country also lacks a network of international agreements. Negotiations are ongoing with its main trade partner, the European Union (EU), regarding LDC graduation, and a potential transition towards a potential GSP+ scheme. This would grant preferential access to up to 66% of tariff lines within the EU market upon proven progress in several areas including transparency, accountability and workers' rights.
- Mobilise resources to meet challenges, including a budget of USD 900 000 for R&D projects in 2021-22 for the High-Tech Park Authority and the Ministry of Science and Technology is too little to engender change in the country. However, the priority is not only to increase resources, but to endow the state with the necessary accountability processes to ensure transparency and efficiency in resource mobilisation. Digital technologies can be leveraged to make all the information related to government spending and investment available to the public.

Figure 1.9. Bangladesh needs to update the current policy approach to transform the economy

Overview of priorities and tools for production transformation, Bangladesh, 2023



Note: The figure is not meant to be exhaustive. It provides a snapshot of the main public instruments that country has in place.
Source: Authors' elaboration based on official information from Bangladesh Finance Division, Ministry of Finance, Country Budget Speech 2022-23. Return to the Path of Development Leaving the COVID-19 Behind and Budget speech 2022-23, https://mof.portal.gov.bd and Bank of Bangladesh, Foreign Exchange Policy Department, https://www.bb.org.bd.

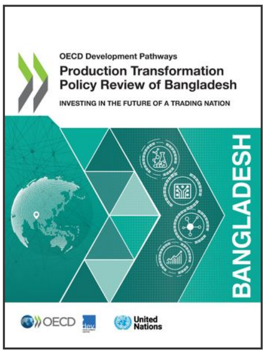
Some noteworthy positive steps include: the advances in national quality infrastructure system which is key to ensure traceability, safety and standards compliance, and the reforms approved in 2022 to update the 1911 patent act, as well as the Start-up Bangladesh initiative. The API Park is a welcome initiative, which needs time to be fully developed. The government and the private sector should also continue engaging in a constructive dialogue reaffirming a shared commitment to prioritising innovation.

Leveraging digitalisation and international partnerships

Digital technologies could transform and make industrial development in Bangladesh inclusive and sustainable. Digitalisation opens innovation, productivity, and sustainability opportunities in all economic areas, both domestic and trade oriented (e.g., agrifood, pharmaceuticals and electronics). It is also essential to transform RMG and to explore opportunities in the circular economy. Digitalisation is pivotal for international accountability, traceability and standards compliance in government and businesses. It can contribute to increasingly associate “made in Bangladesh” with the quality and standards the country is pursuing for its next development phase. Digitalisation also contributes to export diversification, enabling the country to trade digital services and content. Advancing in enabling digitalisation, it is urgent to close digital infrastructure gaps and update the regulatory framework. The 2018 Digital Security Act needs to be amended. Actively engaging in global dialogues on topics such as a regulatory framework for emerging sectors (including AI) is paramount for Bangladesh.

A change in mindset from the international partners is also essential. International partners need to engage with Bangladesh beyond well-worn topics such as responsible business conduct and transparent supply chains. They need to establish comprehensive partnerships to ensure transparent, inclusive, and sustainable business development. This extends to investing in the greening of Bangladesh's energy mix and industrial fabric, while exploring partnerships in the circular economy and bioeconomy.

Bangladesh already has a track record including numerous accomplishments, milestones and a proven capacity to implement reforms and address pitfalls. The country can build on what has been achieved and should accelerate reforms to continue on its path to further success. As the eighth-most populous nation worldwide, Bangladesh has the capacity and responsibility to emerge as a significant player in the multilateral system of tomorrow. A private sector ready to innovate and international partners committed to engage on equal footing with local stakeholders are key going forward. Bangladesh’s prosperous future depends as much on its own domestic efforts as it does on the readiness of international partners to share responsibilities in an effort to help the country improve on its fragilities and to jointly craft a mutually beneficial way of managing openness and doing business.



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